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Chinese Civil Law

C. H. Beck · Hart · Nomos

Chinese Civil Law

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Preface and Acknowledgments

The idea of writing a book on Chinese civil law arose in the course of editing the sister book “Chinese Business Law” in the series of “Beck International”. The importance of civil law, which constitutes the foundation of Chinese private law, is obvious. Accordingly, civil law is the most developed field of private law in the Chinese jurisdiction. Since the end of the 1990s great efforts were undertaken in China to codify its entire civil law. With the fundamental major statutes governing contracts, property, torts and conflict of laws being promulgated in 1999, 2007, 2009 and 2010 respectively, the most crucial steps have been made toward the creation of a Chinese Civil code. The legislator is now facing the challenge of bringing these elements into a coherent system.

Worldwide comparative civil law has gained in importance, what is exemplified in the course of compiling a scholarly draft of a European Civil Code and the tendency of reinvigoration of private law in the US. As the evolvement of Chinese civil law is essentially a process of integrating Chinese tradition and the borrowed foreign legal concepts, the discussion of creating a Chinese Civil Code could further the study of civil law. At the same time, Chinese civil law is also crucial for business operation in China.

That being said, updated, systematic and comprehensive description of Chinese civil law in the English language is scarce. Most fields of civil law remain still inaccessible to interested readers without sufficient proficiency in Chinese language. Thus, the Chinese Civil Law seeks to shed light on both the theoretical and the practical aspects of Chinese civil law. In particular, by giving a large number of references to commentaries, treatises, and articles the authors attempt to deliver an accurate and authentic account of discussions in China, rather than aspire to develop their own ideas, which would otherwise go far beyond the scope of this book. Although case law only plays a marginal role in Chinese law, this book intends to incorporate relevant cases, in particular those adjudicated by the Supreme People’s Court, to illustrate the application of civil law statutes in judicial practice. A bibliography in front of each part and an index at the end of the book allow for further study of specific areas and facilitate systematic research. No English

translations of statutes, judicial interpretations and cases cited in this book are provided as several commercial databases offer such sources. Marriage and succession law is not addressed in a separate chapter, but rather in conjunction with the issues of private international law. All internet sources are last visited in March 2013.

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Chinese Civil Law I

Preface and Acknowledgments I

List of Authors..... I

Abbreviations XV

Part I General Part..... 17

Chapter 1. Overview 18

 I. Evolution of Chinese Civil Law 18

 II. Sources of Civil Law..... 20

 III. General Principles..... 22

 1. Principle of Legal Protection of Civil Rights..... 23

 2. Principle of Equal Status and Principle of Freedom Of Contract..... 23

 3. Principle of Good Faith 24

 4. Principle of Public Policy 25

Chapter 2. Legal Capacity, Legal Representative and Agency 26

 I. Legal Capacity 26

 1. Natural Person..... 26

 2. Legal Person 29

 3. Individual Business, Rural Lease-Based House-Holding Business, and Individual Partnership..... 32

 II. Legal Representative 34

 III. Agency 35

 1. Types of Agency..... 35

 2. Unauthorised Agency and Agency by Estoppel 36

 3. Indirect Agency..... 38

 4. Delegation of Agency 40

 5. Termination..... 40

Chapter 3. Statute of Limitations 42

 I. General Provision..... 42

 1. Legal Nature 42

 2. Scope of Application..... 44

 3. Statute of Limitation, Cut-off Period and Laches Defence..... 45

 II. Period of Limitation 46

 III. Commencement, Suspension, Interruption and Extension of a Period of Limitation..... 48

1. Commencement	48
a. General Provision	48
b. Cause of Action in Tort	48
c. Cause of Action in Contract	48
2. Suspension.....	50
3. Interruption	50
a. General Provision	50
b. Formal Claim to the Court.....	51
c. Request to the Obligor	52
d. Joint Debtors.....	53
e. Transfer of Contractual Rights and Assumption of Obligations	53
4. Extension.....	54
5. Permissibility of Party Agreement.....	54
IV. Statute of Limitations in Guarantee Contract.....	55
Relevant Laws & Regulations.....	56
Part II Contract.....	60
Chapter 4. Overview	61
I. Legislative History of China's Contract Law	61
II. Major Issues in the Legislation Process.....	62
Chapter 5. Formation and Validity of Contracts.....	65
I. Overview	65
1. Formation of Contracts	66
a. Offer	66
(1) Definition	66
(2) Withdrawal and Revocation	67
b. Acceptance	67
(1) Definition	67
(2) Period for Acceptance.....	68
(3) Battle of Forms.....	68
c. Letter of Intent	70
2. Validity of Contracts.....	70
a. Valid Contracts.....	70
b. Void Contracts	70
c. Contracts with Pending Validity.....	74

d. Voidable Contracts.....	75
II. Main issues	75
1. Contract Signature.....	75
a. Contracts without a Seal	76
b. Seal by a Branch of a Corporation.....	76
c. Seal with the Permission of the Seal's Owner	76
d. Seal without the Permission of the Seal's Owner	77
e. Forged Seal	77
2. Form of Contract.....	78
a. Form Requirement.....	78
b. Government Approval or Registration.....	78
3. Advertisements of Rewards.....	80
4. Pre-contractual Liability	81
Chapter 6. Performance, Termination and Cancellation.....	82
I. Performance of Contract.....	83
1. Construction of Contract Terms.....	83
a. Literal Approach.....	84
b. Textual Approach.....	85
c. Purposive Approach.....	86
d. Usages and Practices	87
e. Principle of Good Faith	88
2. Gap-Filling	89
3. Defence	89
a. Defence of Simultaneous Performance	89
b. Defence of Consecutive Performance	90
c. Defence of Safety.....	90
II. Amendment of Contracts	91
III. Change in Circumstances	91
IV. Assignment and Delegation.....	95
1. Assignment of Contractual Rights	95
2. Delegation of Contractual Obligations	96
3. Concurrent Assignment and Delegation.....	97
V. End of a Contract.....	97
1. Rescission	97

2. Set-off	98
3. Escrow	99
4. Legal Consequences of Termination	100
VI. Right of Subrogation	100
1. Prerequisites of Subrogation Rights	101
2. The Procedure of Exercising Subrogation Litigation	102
VII. Right of Invalidation	103
1. Preconditions of the Right of Invalidation	104
2. The Procedure of Exercising Right of Invalidation	104
3. Legal Effect of Right of Invalidation	105
Chapter 7. Liability for Breach of Contract	106
I. Overview	107
1. Definition of Breach of Contract	107
2. Attribution Principle of Liability	107
3. Election of Remedy in Tort or in Contract	110
II. Main issues	110
1. Specific Performance	110
2. Defects Liability	111
3. Liability for Damages	112
a. Basic Principles	112
b. Calculation of Lost Profit	116
c. Non-Pecuniary Damages	117
d. Punitive Damages	118
4. Liquidated Damages	119
a. Permissibility	119
b. Adjustment to the Amount of Liquidated Damages	120
5. Deposit	121
Chapter 8. Standard Form Contracts	122
I. Overview	122
II. Main Issues	123
1. Towards a More Accurate Definition	123
2. Model Contracts v Standard Form Contracts	125
3. Incorporation of Standard Terms into a Contract	125
4. Inconsistency between art. 39 and art. 40?	126

5. Battle of Forms 128

6. Interpretation 130

Chapter 9. Particular Types of Contracts..... 131

 I. Background 132

 II. Purchase and Sales Contracts..... 133

 1. Overview..... 133

 a. Definition 133

 b. Major Rights and Obligations of Parties..... 134

 c. Arts. 61 and 62 CL 134

 2. Delivery..... 135

 a. Forms of Delivery..... 135

 b. Time of Delivery 136

 c. Place of Delivery 137

 d. Excessive Delivery..... 138

 3. Payment of Price 138

 a. Amount of Payment 138

 b. Place of Payment..... 139

 c. Time of Payment..... 139

 4. Transfer of Ownership 139

 5. Passing on the Risk of Loss 140

 a. General Rule..... 140

 b. Specific Rules 141

 6. Defect Warranty..... 143

 a. Warranty on Ownership 143

 b. Warranty on Quality 144

 c. Inspection..... 145

 7. Rescission of a Sales Contract in Whole or in Part 146

 8. Special Types of Purchase and Sales Contracts 147

 a. Payment by Installments..... 147

 b. Trial Use..... 148

 c. Bidding and Auction 149

 III. Gift Contracts 149

 1. Overview..... 149

 2. Validity of a Gift Contract..... 149

3. Promisor's Right to Revoke	150
a. Revoke by Free Will.....	150
b. Revoke by Law	151
c. Exemption from Performance	152
4. Indemnity	153
a. Loss of Gifts	153
b. Defects in Gifts.....	154
5. Protection of the Promisee's Reliance Interest.....	154
IV. Lease Contracts.....	155
1. Overview.....	155
2. The Period and Form of a Lease Contract	156
3. Appropriate Use of the Leased Object	156
4. Payment of Rent.....	157
5. Defect Warranty.....	157
6. Changes in the Leased Object's Ownership During the Lease Contract ...	158
7. Sublease.....	160
8. Termination and Extension of a Lease Contract	160
V. Service Contracts	161
1. Overview.....	161
2. The Contractor's Obligation to Complete the Work by Himself	162
3. The Parties' Obligations During Work	162
4. Delivery of Work, Payment, and Breach of Contract.....	163
5. Distinctions Between a Service Contract and a Sales Contract.....	164
6. Distinctions Between a Service Contract and an Employment Contract....	165
Relevant Laws & Regulations.....	168
Part III Tort.....	171
Chapter 10. Overview	172
I. The Evolution of Chinese Tort Law	173
1. Concept and Function of Tort Law	173
2. Codification of Tort Law.....	175
3. Sources of Law.....	177
4. Concurrent Liability.....	179
II. Attribution Principles and Special Forms of Tort Liability	179
1. Attribution Principles.....	179

2. No-fault Liability	180
3. Special Forms of Tort Liability	181
a. Fairness Liability/Equity Liability	181
b. Supplemental Liability	182
c. Non-Genuine Joint and Several Liability	184
III. Prerequisites of Tort Liability	184
1. Conduct	184
2. Damage	185
3. Causation	185
4. Fault	186
5. Illegality	186
IV. Liability of Several Persons	187
1. Joint and Several Liability	188
2. Joint Tort (共同加害)	188
3. Joint Danger/Alternative Causation (共同危険)	189
4. Joint Cause/Concurrent Causation (原因竞合)	190
5. Summary	190
V. Relief	191
1. Types of Relieves	191
2. Injunctive Relief	192
3. Compensation	192
a. Pecuniary Loss	193
b. Mental Distress/Non-pecuniary Loss	195
c. Disgorging the Gain	199
VI. Exclusion and Reduction of Liability	199
1. Fault Offset/Concurrent Fault	199
2. Conduct of A Third Party	201
3. Force Majeure	202
4. Self-defence and Necessity	202
5. Assumption of Risk	203
Chapter 11. General Provision on Tort Liability	204
I. Background	205
II. Model in the LTL	206

III. Rights v. Interests	208
1. Terminology.....	208
2. Determination of Protected Interests.....	209
IV. Case Groups.....	210
Chapter 12. Special Types of Torts	213
I. Vicarious Liability	214
1. Liability of Employers.....	215
a. Establishment of Employment Relationship.....	216
b. Work-Related Tasks	216
c. Fault and Misconduct of the Employee	216
d. Liability of Legal Person's Organs	217
e. Right to Recourse	217
f. Labor Dispatch.....	217
g. Industrial Injury.....	218
II. Children' Liability for Torts and Personal Injury.....	218
1. Parent's Liability	218
2. Liability of Educational Establishments	220
III. Liability based on Legal Duty to Maintain Safety	220
IV. Defamation	222
1. Background	222
2. Determination of Defamation.....	223
a. Criteria	223
b. Defamatory Conduct.....	224
c. Illegality	225
d. Damage to the Reputation	225
e. Fault.....	226
f. Liability of Editor, Publisher and Informant	226
g. Defences.....	227
h. Defamation Lawsuits of Deceased	228
i. Relief.....	229
j. Procedural Aspects	230
V. Product Liability	230
1. Background	230
2. Nature of Liability.....	231

3. Major Aspects.....	231
a. Defect.....	231
b. Manufacturer and Distributor	232
c. Liability Scope	232
d. Procedural Aspects.....	234
e. Defences.....	234
VI. Liability for Accidents Involving Motor Vehicles	234
1. Background	234
2. Nature of Liability.....	235
3. Recovery from the Insurance	236
4. Liability for Rented Vehicles	237
5. Liability for Sold Vehicles.....	238
6. Liability for Stolen, Converted, Looted, Unidentified or Uninsured Vehicles.....	238
7. Liability for Unsuitable Vehicles.....	239
VII. Liability for Medical Damage.....	239
1. Background	239
2. Nature of Liability.....	240
3. Determination of Fault	241
4. Informed Consent.....	243
5. Liability for Drugs.....	243
6. Defences	244
VIII. Environmental Liability.....	244
1. Background	244
2. Nature of Liability.....	245
3. Shift in Burden of Proof of Causation	246
4. Several Polluters	246
5. Pollution Caused by a Third Party	248
6. Relief	249
7. Defences	249
8. Procedural Aspects	249
IX. Animal Owner's Liability.....	250
1. Background	250
2. Nature of Liability.....	250
3. Misconduct and Causation	252

4. Abandoned or Escaping Animals	253
5. Third Party's Liability	253
X. Liability for Objects	253
1. Background	253
2. Nature of Liability.....	254
Relevant Laws & Regulations.....	256
Part IV Property	259
Chapter 13. Overview	260
I. The Real Rights Law in its Context.....	260
II. Other Sources of Law	262
III. Functions of Real Rights Legislation.....	263
IV. Sole Ownership	263
V. Joint Ownership.....	264
1. Two Types of Joint Ownership	264
2. Common Features.....	265
3. (Non-) Existence of Individual Shares	265
4. Disposal and Major Repair	266
5. Severance	267
6. Claims and Liabilities.....	267
VI. Different Types of Owners	268
VII. Encumbrances.....	269
VIII. Objects of Real Rights	269
IX. Principles of Real Rights Law	270
1. Equal Protection of different Types of Owners	270
2. Absoluteness	270
3. Legal Prescription (<i>numerus clausus</i>)	271
4. Specificity	271
5. Publicity	272
X. Protection of Real Rights	272
1. Real Rights Claims vs. Tort Liability	272
2. Other Provisions	272
3. Statute of Limitation.....	273
XI. Possession: Concept and Types	274
XII. Protection of Possession	274

1. Restitution/Elimination of Interference..... 274

2. Compensation 275

XIII. Claims against the Possessor 276

Chapter 14. Acquisition of Ownership 277

I. Conveyance of Title 278

1. Transfer by a Single Legal Act 278

2. General Remarks on Publicity Requirements..... 280

3. Publicity Requirements Regarding Movable Property 281

 a. Delivery 281

 b. Registration..... 282

4. Publicity Requirements Regarding Immovable Property 283

5. Dualistic Function of Registration 285

6. Retention of Title 286

7. Multiple Sale 288

II. Acquisition in Good Faith 289

1. Good Faith..... 290

2. Reasonable Price 292

3. Publicity 293

4. Burden of Proof 294

5. Lost Property 295

6. Legal Tender 298

7. Real Security Rights 298

III. Other Ways of Acquisition and Loss of Ownership 298

1. Fruits..... 298

2. Trove 299

3. Succession 299

4. Expropriation; Transfer by Court Decision..... 300

5. Concepts not Covered by the Law 300

Chapter 15. Condominium Property 302

I. Overview 302

II. Combination of Sole and Joint Ownership 303

III. General Meeting of the Proprietors/Proprietors' Committee 305

IV. Exclusive Rights to Use Common Parts 306

V. Management Statutes..... 307

VI. Realty Management.....	308
Chapter 16. Usufructuary Rights	309
I. Overview	309
II. Right to the Use of Land for Construction	310
III. (Rural) Land Contracted Management Right	312
IV. Right to the Use of (Rural) Residential Housing Land	313
V. Easement on Land.....	314
Chapter 17. Real Estate Purchase Agreement.....	316
I. Overview	316
II. Validity and Contents of the Contract.....	316
III. Passing of Risk	317
IV. Registration and Ownership Certificate	317
Relevant Laws & Regulations.....	319
Part V Conflict of Laws	321
Chapter 18. Overview	322
I. Debate on the Scope of Private International Law	322
II. Historical Review of Private International Law	324
III. Framework of Private International Law Prior to the Promulgation of the LAL	326
IV. LAL	327
V. China's Private Interregional Law	329
VI. Principles and General Rules of CPIL	330
1. Principles of Chinese Private International Law	331
2. General Rules of Chinese Private International Law	333
VII. Recognition and Enforcement of Foreign Judgments and Arbitral Awards .	334
1. Recognition and Enforcement of Foreign Arbitral Awards.....	334
2. Recognition and Enforcement of Foreign Judgments	336
Chapter 19. Subjects of Civil Relations	338
I. General Introduction.....	338
II. Natural Persons	339
1. Legal Capacity for Civil Rights.....	339
2. China's Unique "Huji" System and Private International Law	341
3. Nationality of Natural Persons	342
4. Legal Capacity for Civil Conducts.....	344

III. Legal Person 347

1. Nationality of a Legal Person..... 347

2. Domicile of a Legal Person..... 349

3. Capacities of Legal Persons 350

IV. State and International Organizations 352

V. Legal Status of Foreigners in China 354

Chapter 20. Family, Marriage, and Succession..... 356

I. Marriage 356

1. Substantive Requirements 356

2. Formal Requirements 358

II. Matrimonial Relations..... 359

1. Matrimonial Personal Regime 359

2. Matrimonial Property Regime 360

III. Divorce 361

1. Divorce by Agreement 361

2. Divorce by Litigation 362

IV. Family Relations 363

1. Parent-Child Relations..... 363

2. Adoption 364

3. Maintenance 366

4. Guardianship 367

V. Succession 368

1. Intestate Succession 368

2. Testate Succession 370

3. Management of Estates..... 371

4. Succession of Heirless Estates 372

Chapter 21. Property Rights, Obligations and Intellectual Property Rights 373

I. Introduction 373

II. Property Rights (Real Rights) 374

1. Immovables 375

2. Movables 375

3. Securities..... 376

4. Pledge of Rights 377

III. Contract..... 378

1. The Party Autonomy Principle	378
2. The Closest Connection Principle	383
3. Consumer Contract	384
4. Employment Contract	386
IV. Tort	388
1. Tort in General.....	389
2. Product Liability	391
3. Infringement on the Rights of Personality via the Media	394
V. Unjust Enrichment and Management without Mandate	396
VI. Intellectual Property Rights (IPRs).....	397
1. Entitlement and Contents of Intellectual Property Rights	398
2. Transfer and Licensing of Intellectual Property Rights	399
3. Intellectual Property Rights Infringement.....	400
Relevant Laws & Regulations	402

Abbreviations

Opinions on the GPCL	Opinions of the Supreme People's Court on Several Issues concerning the Implementation of the GPCL of the People's Republic of China
Answers to the Trial of Cases Involving Rights to Reputation	Answers of the Supreme People's Court on Several Issues Relevant to the Trial of Cases Involving Rights to Reputation
AUCL	Anti-Unfair Competition Law
Berne Convention	Berne Convention for the Protection of Literary and Artistic Works
BIT	Bilateral Investment Treaty
CCP	Chinese Communist Party
CEO	Chief Executive Officer
CISG	United Nations Convention On Contracts For The International Sale Of Goods
CL	Contract Law
CPL	Civil Procedural Law
DCFR	Draft Common Frame Reference
ECL	Economic Contract Law
FECL	Foreign Economic Contract Law
GPCL	General Principles of Civil Law
HK Basic Law	Basic Law of the Hong Kong Special Administrative Region
Hong Kong SAR	Hong Kong Special Administrative Region
ICC	International Chamber of Commerce
Interpretation on Liability of Traffic Accidents	Interpretation of the Supreme People's Court on Issues Concerning the Application of Law in the Trial of Cases Involving Traffic Accidents
Interpretation on the CL (Part 1)	SPC's Interpretations of Certain Issues Concerning the Application of the Contract Law (Part I)
Interpretation on the CL (Part 2)	SPC's Interpretations of Certain Issues Concerning the Application of the Contract Law (Part II)
Interpretations on Mental Damages	Interpretation of the Supreme People's Court on Several Issues Concerning the Ascertainment of Compensation Liability for Non-Material Damages in Civil Torts
Interpretation on Personal Injuries	Interpretation of the Supreme People's Court on Several Issues Concerning the Law Applicable in Hearing Cases of Compensation for Personal Injury
Interpretations to the Trial of Cases Involving Rights to Reputation	Interpretations to Several Questions in the Trial of Cases Involving Rights to Reputation
IP	Intellectual Property
IPR	Intellectual Property Rights
LAL	Law of the Application of Law for Foreign-related Civil Relations
L/C	Letter of Credit
LLC	Limited Liability Companies
Ltd	Limited
LTl	Law on Tort Liability
Macao Basic Law	Basic Law of the Macau Special Administrative Region
Macao SAR	Macao Special Administrative Region
Madrid Agreement ...	Madrid Agreement for International Registration of Trademarks
ML	Marriage Law
Model PIL	Model Private International Law Code

New York Convention	1958 Convention of Recognition and Enforcement of Foreign Arbitral Awards
NGO	Non-Governmental Organization
NPC	National People's Congress
OCTS policy	"One Country Two Systems" policy
Paris Convention	Paris Convention on the Protection of Industrial Property
PICC	Principles of International Commercial Contracts
PQL	Product Quality Law
PRC	People's Republic of China
RRL	Real Rights Law
RMB	Renminbi
Rome Convention	Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations
RTSL	Road Traffic Safety Law
SAIC	State Administration of Industry and Commerce
SARS	Severe Acute Respiratory Syndrome
SCNPC	Standing Committee of the National People's Congress
SL	Succession Law
SOE	State-owned Enterprise
SPC	Supreme People's Court (of the PRC)
SPC Commodity Premises Interpretation	Interpretation of the SPC on the Relevant Issues concerning the Application of Law for Trying Cases on Dispute over Contract for the Sale of Commodity Premises
SPC Condominium Interpretation	Interpretation of the SPC on Several Issues Concerning the Specific Application of Law in the Trial of Disputes over Condominium Ownership in Buildings
SPC Interpretation on Lease Contracts of Urban Houses	Interpretation of the SPC on Several Issues Concerning the Application of Law in the Trial of Cases Involving Disputes Arising From Lease Contracts of Urban Houses
SPC Interpretation on Purchase and Sales Dispute Cases	Interpretation of the SPC on Several Issues About the Application of Law for the Trial of Purchase and Sales Dispute Cases
SPC Judicial Interpretation No. 2007-14	Rules of the Supreme People's Court on the Relevant Issues concerning the Application of Law in Hearing Foreign-Related Contractual Dispute Cases in Civil and Commercial Matters
SPC Lease Contract Interpretation	Interpretation of the SPC on Several Issues Concerning the Application of Law in the Trial of Cases about Disputes over Lease Contracts on Urban Buildings
SPC Purchase Contract Interpretation	Interpretation of the SPC on Issues Concerning the Application of Law in the Trial of Cases about Disputes over Purchase and Sale Contracts
SPC Realty Services Interpretation	Interpretation of the SPC on Several Issues Concerning the Specific Application of Law in the Trial of Disputes over Realty Services
SPC Rules on Period of Limitation	SPC Rules on Certain Issues Concerning the Implementation of Period of Limitations in Civil Litigation
TCL	Technology Contract Law
TRIPs	Agreement on Trade-Related Aspects of Intellectual Property Rights
UNDROIT	International Institute for the Unification of Private Laws
U.S.	United States
WFOE	Wholly Foreign-owned Enterprise
WIPO Convention	Convention Establishing the World Intellectual Property Organization
WTO	World Trade Organization

Part I General Part

Chapter 1. Overview

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I. Evolution of Chinese Civil Law

- 1 The equivalent Chinese word for civil law is “民法”, which includes two characters: 民 and 法. The character 民 (*Min*) means “people” and the character 法 (*Fa*) means “law”. Therefore, a simple way to translate civil law in Chinese is “the law of people”.
- 2 In the current Chinese legal system, the Constitution¹ sets out (i) the fundamental rights and obligations of each citizen and (ii) the structure of the country. Following the general principles stated in the Constitution, civil law, criminal law, and administrative law are the three most important substantial law constituents² of the Chinese legal system, ranking beneath the Constitution and each covering a crucial and different area of legal relations. As described by art. 2 of the General Principles of Civil Law (GPCL)³, civil law deals with property and personal relationships among citizens and legal persons. The focus of civil law is to regulate legal relations between equal counterparts.

¹ 宪法, promulgated on and effective from 4th December, 1982.

² Together with the corresponding procedure laws.

³ 民法通则, promulgated by the NPC on 12th April, 1986 and effective from 1st January, 1987.

However, unlike other civil law jurisdictions, the People's Republic of China (PRC) **3** has not yet enacted one comprehensive modern civil code. Since 1949, there have been at least four rounds of drafting projects mandated by the National People's Congress (NPC) with the goal of creating a comprehensive Chinese civil code. The first round produced a draft in 1956, which was based on the Civil Code of the Soviet Union. The second code was drafted in 1964 and highlighted the characteristics of a planned economy. The start of China's reform and "open door" policy in 1978 triggered the establishment of a new civil law drafting committee. However, after the third attempt to prepare a complete civil code failed, due to various reasons⁴, the GPCL⁵, based on the principle of "only including well developed provisions"⁶, was eventually enacted on 12th April, 1986. The GPCL is neither a comprehensive civil code nor a piece of legislation focusing on one particular civil law subject. Some scholars referred to it as a "quasi" Civil Code⁷ and praised it for strengthening the protection of private rights and reducing the influence of the Civil Code of the Soviet Union⁸. Given the fast development of China's economy, the NPC formally started the fourth round of drafting a thorough civil code in 2002. This consisted of a clear, initial plan to separately complete the legislation of all-important subjects of civil law, especially contract law and property law, and then to assemble a comprehensive civil code.

Although the majority of Chinese legal scholars agree that China should have a **4** unified civil code, there has not been a universally accepted opinion on its general structure. The most popular of these schools of thought include: (i) the open and loose structure, (ii) the classical Roman/French civil law structure following *Institutiones*, and (iii) the classical German civil code structure following *Pandektae*.⁹ Furthermore, some experts have preferred to have a separate code for private international law rather than to include it in the civil code.¹⁰ It has also been argued

⁴ YANG Linxin/WANG Yi/WANG Zhu/WANG Tianfan/ZHAO Ke, 99. The most important debate during that period was between the development of civil law and economic law. It was argued by some scholars that it is unnecessary to have civil law since the relevant rules are already covered under the wider concept of economic law. RAN HAO/DU LIHONG, 68.

⁵ It was regarded as a mini version of the civil code. ZHANG Xinbao, 103.

⁶ 成熟一条制定一条, WANG LIMING, 26.

⁷ LIU Kaixiang, 2.

⁸ LIANG Huixing, 22.

⁹ YANG Lixin, 101.

¹⁰ LIU Kaixiang, 18.

that intellectual property law should be added to the civil code.¹¹ The 2002 draft of the civil code consists of nine parts: (1) general provisions, (2) law of real rights, (3) law of contract, (4) law of personality rights, (5) law of marriage, (6) law of adoption, (7) law of succession, (8) law of tort liability, and (9) private international law.¹²

II. Sources of Civil Law

- 5 As mentioned above, the PRC has not yet enacted its comprehensive civil code. However, this does not imply there is no well-developed civil law in China. Following continuous efforts made by Chinese legislators and legal scholars over the last 30 years, civil law has already become the most developed and heavily legislated subject in China. Currently, apart from the fundamental rules set out in the constitution, there are roughly six different categories of sources of civil law listed below, which cover most areas expected to be included in a comprehensive civil code.¹³
- 6 (1) Main statutes in relation to civil law enacted by the NPC and its Standing Committee: GPCL, Contract Law (CL)¹⁴, Real Rights Law¹⁵, Security Law¹⁶, Tort Liability Law¹⁷, Succession Law¹⁸, Marriage Law¹⁹ and Adoption Law²⁰.
- 7 (2) Administrative regulations issued by the State Council or the relevant ministries: Regulations for the Registration of Enterprises as Legal Persons²¹, Interim Regulations on Registration and Administration of Institutions²², Regulations on Registration and Administration of Associations²³, Provisional Regulations for the

¹¹ Ibid.

¹² *Liu Kaixiang*, 17-18.

¹³ Some scholars argue that there are three general sources of law: legislations, state policies and customs. *Liu Kaixiang*, 30 - 34.

¹⁴ 合同法, promulgated by the SCNPC on 15th March, 1999 and effective from 1st October, 1999.

¹⁵ 物权法, promulgated by the NPC on 16th March, 2007 and effective from 1st October, 2007.

¹⁶ 担保法, promulgated by the SCNPC on 30th June, 1995 and effective from 1st October, 1995.

¹⁷ 侵权责任法, promulgated by the SCNPC on 26th December, 2009 and effective from 1st July, 2010.

¹⁸ 继承法, promulgated by the NPC on 4th October, 1985 and effective from 1st October, 1985.

¹⁹ 婚姻法, promulgated by the NPC on 10th September, 1980 and effective from 1st January, 1981.

²⁰ 收养法, promulgated by the NPC on 29th December, 1991 and effective from 1st April, 1992.

²¹ 企业法人登记管理条例, promulgated by the State Council on 3rd June, 1988 and effective from 1st July, 1988.

²² 事业单位登记管理暂行条例, promulgated by the State Council on effective from 25th October, 1998.

²³ 社会团体登记管理条例, promulgated by the State Council on 25th October, 1998 and effective from 25th October, 1998.

Registration and Administration of Privately-Run Non-Enterprise Institutions²⁴, Regulations on Foundation Administration²⁵, and Implementation Rules for Regulations on the Registration of Enterprises as Legal Persons²⁶.

(3) Judiciary interpretations issued by the Supreme People’s Court (SPC). Although 8 China has a codified legal system and an earlier court judgement does not automatically bind future court proceedings, in practice, the official interpretation issued by the SPC does have binding authority and is followed by legal practitioners in order to clarify difficult civil law related issues. Important judiciary interpretations issued by the SPC in respect of the civil law issues include: Opinions of the SPC on Certain Issues Regarding the Implementation of General Principles of Civil Law of the People's Republic of China (Trial)²⁷, the SPC Rules on Certain Issues concerning the Implementation of a Period of Limitations in Civil Litigation²⁸, the Opinions of the SPC on Certain Issues concerning the Implementation of the Civil Procedure Law of the People's Republic of China²⁹, SPC Interpretation on Certain Issues Regarding the Implementation of the Contract Law of the People's Republic of China (Part I)³⁰, Interpretation of the SPC on Certain Issues concerning the Implementation of the Contract Law of the People's Republic of China (Part II)³¹; and Interpretation of the SPC on the Security Law of the People's Republic of China³².

(4) Regulations enacted by a provincial congress which sets out specific 9 implementation rules applicable in the relevant province.

24 民办非企业单位登记管理暂行条例, promulgated by the State Council on 25th October, 1998 and effective from 25th October, 1998.
25 基金会管理条例, promulgated by the State Council on 8th March, 2004 and effective from 1st June, 2004.
26 企业法人登记管理条例施行细则, promulgated by SAIC on 3th November, 1988 and effective from 1st December, 1988.
27 最高人民法院关于贯彻执行《中华人民共和国民法通则》若干问题的意见(试行), promulgated on 26th January, 1988 (hereinafter: Opinions on GPCL).
28 最高人民法院关于审理民事案件适用诉讼时效制度若干问题的规定, promulgated on 21st August, 2008 and effective from 1st September, 2008.
29 最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见, promulgated on 14th July, 1992.
30 最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(一), promulgated on 19th December, 1999 and effective from 29th December, 1999.
31 最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(二), promulgated on 24th April, 2009 and effective from 13th May, 2009.
32 最高人民法院关于适用《中华人民共和国担保法》若干问题的解释, promulgated on 8th December, 2000 and effective from 13th December, 2000.

- 10 (5) State policies. Art. 6 of the GPCL states that if there is no applicable rule expressly provided by law, the relevant civil activity should comply with state policies. This seems to be a part of the remains from the transitional period between the earlier planned economy and the current market-oriented economy. It is worth repeating that the GPCL was enacted in 1986, an early stage of China's economic reform.
- 11 (6) Local customs. The GPCL does not expressly refer to local customs. However, some leading scholars hold the view that local customs should be included as a source of civil law rules and quote art. 85 Real Rights Law as an example.³³ In accordance with art. 85 Real Rights Law, unless there are relevant rules set out by law or regulation, the neighbouring relations should be dealt with pursuant to local customs.

III. General Principles

- 12 The Chinese legal system is a codified one, and unlike common law jurisdictions, previous court judgements do not have an automatically binding effect. Meanwhile, legal practitioners cannot expect the SPC to issue judicial interpretations to clarify every point. As a result, almost every major piece of legislation in China sets out a series of its general principles. If there is any ambiguity in understanding an issue in a statute and that point is not covered by the judicial interpretation previously issued by the SPC, the relevant general principles will be used to infer an appropriate interpretation.
- 13 In this regard, there is no exception to the Chinese civil law. It is generally agreed among Chinese legal scholars that the basic principles of civil law should apply throughout the civil law legislative process, judicial determination, and relevant civil activities.³⁴ Therefore, before analysing any specific concept, it is important to understand the general principles of Chinese civil law.
- 14 At present, the GPCL is the fundamental statute which sets forth all the basic principles and concepts in the Chinese civil law family. However, the details regarding the basic principles of civil law remain a heatedly debated subject among

³³ LIANG Huixing, 27-28.

³⁴ YANG Lixin, 102.

Chinese legal academics.³⁵ Five general principles, as arranged below, are commonly referred to by legal scholars: legal protection of civil rights, equal status, freedom of contract, good faith, and public policy.³⁶

1. Principle of Legal Protection of Civil Rights

The essence of this principle is straightforward: any natural person or legal person's legal civil rights are protected by law and are not allowed to be infringed by any other organisation or individual.³⁷ In contrast, with emphasis on protecting the assets of the state and the power of the government, the focus on protecting civil rights of each individual or legal person is widely regarded as the direction of Chinese civil law development. Many Chinese scholars either rank this principle as the first general principle or categorise it as the fundamental principle and purpose of Chinese civil law.³⁸ 15

2. Principle of Equal Status and Principle of Freedom Of Contract

Art. 3 GPCL makes it clear that each party has equal status in any civil activity. Even if one party is a public authority, when dealing with civil issues, such as entering into a contract with subjects governed by civil law, it is prohibited from enforcing the relevant counterpart to agree to any terms against their free will. This logically links with the Principle of Freedom of Contract. Unless otherwise restricted by law, the parties are free to negotiate the terms of civil activity between them. 16

The Principle of Equal Status is particularly important in a jurisdiction which has experienced the transition from a planned economy to a market-oriented economy, since in a planned economy a contractual party may be forced to enter into an unfair agreement following the supply and demand plan set out in advance by the state.³⁹ 17

³⁵ Ibid. Some scholars believe that there are five general principles while others list six, *LIU Kaixiang*, 26 - 30; *LIANG Huixing*, 46 - 52.
³⁶ *LIU Kaixiang*, 26 - 30.
³⁷ Art. 5 GPCL.
³⁸ *LIU Kaixiang*, 26 - 37; *LIANG Huixing*, 42 - 44.
³⁹ *LIANG Huixing*, 46.

3. Principle of Good Faith

- 18 Pursuant to art. 4 GPCL, civil activities should follow the Principle of Good Faith. This principle requires parties (i) to ensure fairness and equality of each civil activity, (ii) to respect counterparties' rights, and (iii) to avoid abusing his/her own civil rights.⁴⁰ This is the moral standard in a market-oriented economy.⁴¹ Art. 6 Contract Law also expressly requires contractual parties to carry out their rights and perform their obligations in accordance with the Principle of Good Faith.
- 19 For example, in the case of *Changsha Xianfeng Branch of the Agricultural Bank of China v Hunan Golden Sail Investment Management Co., Ltd. and Changsha Jinxia Construction & Development Co., Ltd.* in respect to a dispute regarding a loan agreement and corresponding security agreement,⁴² the purpose of the loan, as manually written in the original loan agreement provided by the bank, is to be used as "working capital and for the repayment of a pre-existing loan". However, the purpose of the loan, as manually written in the original loan agreement provided by the mortgagor, is only to be used as "working capital". The mortgagor refused to perform its obligations as the mortgagor when the borrower used the new loan to repay pre-existing debt and consequently failed to repay the new loan on the basis that the new loan was not used for its agreed purpose. The SPC held that (i) the common interpretation of the purpose of working capital should include the repayment of previous outstanding debt; (ii) since the mortgagor is aware of the borrower's pre-existing debt, if the mortgagor is not willing to provide collateral for any loan borrowed by the borrower for the repayment of existing debt, the mortgagor should insert a restricting provision in the pertinent loan agreement; and (iii) without the expression of any restricting clauses, based on the Principle of Good Faith, the mortgagor is then prohibited from interpreting the contractual terms in such a narrow way by which common commercial understanding is not reflected. It has been argued by Chinese scholars that this principle under Chinese civil law is the "emperor provision".⁴³

⁴⁰ *Liu Kaixiang*, 29.

⁴¹ *LIANG Huixing* 269.

⁴² 中国农业银行长沙市先锋支行与湖南金帆投资管理有限公司、长沙金霞开发建设有限公司借款担保合同纠纷案, judgement of the SPC dated 28th April, 2008.

⁴³ *Liu Kaixiang*, 29.

4. Principle of Public Policy

Civil activities should also respect social ethics and should not prejudice any public policy or disturb social economic order.⁴⁴ Compared to other general principles, this principle is intended to impose certain limits on the autonomy of civil activities. Thus, in accordance with art. 58 GPCL, any civil activity, which violates public interest, is void. However, the recent development of this principle seems to be in favour of reducing restriction on the protection of civil rights. For instance, following the decision issued by the Standing Committee of the National People's Congress (SCNPC) to amend certain legalisation⁴⁵, the principle that any civil activity should not violate the state's economic plan is deleted from art. 7 GPCL.

⁴⁴ Art. 7 GPCL; art. 7 CL.

⁴⁵ 关于修改部分法律的决定, promulgated on and effective from 27th August, 2009.

Chapter 2. Legal Capacity, Legal Representative and Agency

Literature: *CAI Hui* (蔡晖)/*WANG Ruifeng* (王瑞峰), Unborn Baby's Rights and the Approach to Protect such Rights (胎儿权利及其司法保护的途径), *People's Judiciary* (人民司法) 2007, No. 1, 87-89. *DONG Xueli* (董学立), Re-analysis and Design of Unauthorised Agency (重新审视和设计无权代理), *Legal Science Monthly* (法学) 2006, No. 2, 61-66. *LIANG Huixing* (梁慧星), General Introduction to Civil Law (4. ed.) (民法总论), Beijing 2011. *LI Jianhua* (李建华), Civil Law Should Establish Rules on Interdicted Person (我国民法应建立禁治产人制度), *Jilin University Journal Social Sciences Edition* (吉林大学社会科学学报) 1999, No. 6, 15-20. *LIU Kaixiang* (刘凯湘), General Introduction to Civil Law (3. ed.) (民法总论), Beijing 2011. *LI Yunbo* (李云波), Monism in the Civil Capacity of Legal Person (法人民事能力一元论), *Journal of Yangzhou University (Humanities & Social Sciences)* (扬州大学学报(人文社会科学版)) 2010, No. 5, 40-45. *RAN Hao* (冉昊)/*DU Lihong* (杜丽红), The Way to Rule of Law in New China: A Review of Civil Law in a History of 56 Years (新中国法治历程: 民法 56 年), *Journal of Nanjing University (Philosophy, Humanities and Social Sciences)* (南京大学学报(哲学·人文科学·社会科学版)) 2005, No. 4, 66-75. *SUN Peng* (孙鹏), The Indispensability of Civil Rights and Capacity for Civil Rights (民事权利与民事权利能力不可分), *Politics and Law Journal* (政治与法律) 1996, No. 1, 30-32. *WU Qinwang* (吴清旺), Comparative Study of Agency Law and Models (代理法范式比较研究), *Gansu Social Science* (甘肃社会科学) 2004, No. 2, 155-158. *XU Liwen* (徐丽雯), Analysis of the Interpretation of Agency by Estoppel in the SPC Judicial Interpretation of the Contract Law No. 2 (对《〈合同法〉司法解释(二)》中"表见代理"释义的探讨), *Journal of Capital University of Economics and Business* (首都经济贸易大学学报) 2009, No. 6, 73-75. *XUE Hong* (薛虹), The Review of the Development of Chinese Civil Law in the Twentieth Century (二十世纪中国民法学回顾), *Chinese Academy of Social Sciences Graduate School Journal* (中国社会科学院研究生院学报) 1999, No. 5, 53-62. *YANG Lixin* (杨立新)/*WANG Yi* (王轶)/*WANG Zhu* (王竹)/*WANG Tianfan* (王天凡)/*ZHAO Ke* (赵可), The Thirty Years of Chinese Civil Law (中国民法学三十年), Beijing 2008. *YANG Tao* (杨涛), The Legal Theory Analysis of Civil Capacity Right (权利能力法理分析), *Discovery* (探索) 2005, No. 2, 188-190. *YE Jinqiang* (叶金强), Analysis of the Reasoning Structure of Agency Rights (论代理权授予行为的有因构造), *Tribune of Political Science and Law* (政法论坛) 2010, No. 1, 109-114. *YIN Tian* (尹田), Analytical Study of Agency by Estoppel in the Newly Enacted Contract Law (我国新合同法中的表见代表制度评析), *Modern Law Science* (现代法学) 2000, No. 5, 114-117.

I. Legal Capacity

1. Natural Person

- 1 Arts. 9 and 10 GPCL provide that each citizen has equal capacity for civil rights from his or her birth until he or she dies. During the legislative deliberation process, it was

debated whether the references to "citizen" in the GPCL should be replaced by "natural person".¹ Since "citizen" is a term commonly used in public law, many scholars took the view that it was more appropriate to refer to "natural person" in civil law and references to "citizen" reflect the heavy influence public law had during the early stages of the enactment of Chinese civil law.² In 1999, when Contract Law was enacted, the concept of "natural person" was referred to instead of "citizen",³ which was widely regarded as a positive development.⁴ To avoid any potential confusion, the term "natural person" rather than "citizen" is used in this chapter.

A natural person's capacity for civil rights starts when he or she is born. According to 2 generally agreed interpretation, a child is born when the whole body of the child is separated from the mother, provided that the child remains alive immediately after the separation.⁵ The time of birth for a natural person is determined by the information listed on the household registration certificate or, if there is no household registration certificate, on said person's birth certificate, issued by the hospital.⁶

According to the traditional view, a natural person's capacity for civil rights is the 3 indispensable premise for having any civil right. However, it has been suggested by some scholars that it is possible to separate the two concepts in certain circumstances such as the personal rights of a deceased person or the inheritance rights of an unborn baby.⁷ Counter to this one could argue: (i) the protection of a deceased person's rights is in fact the protection of the rights of either the relevant heir/heirress (if there is one) or public policy (if the deceased person does not have any heir/heirress); and (ii) in an inheritance case, an unborn baby is deemed to have been born, but that assumption would be revoked if the baby dies before birth.⁸ Interestingly, different courts also hold distinctive views on this point. In two similar traffic accident cases, one court supported, while another court dismissed, claims to compensate the future cost for raising an unborn baby.⁹

¹ YANG Lixin, 104.
² RAN Hao/DU Lihong, 71; LIU Kaixiang, 101-102.
³ E.g., art. 2 of the Contract Law.
⁴ LIU Kaixiang, 102.
⁵ LIANG Huixing, 88.
⁶ Art. 1 of the Opinions on GPCL. It is worth noting that in China a birth certificate is issued by a hospital instead of a governmental agency.
⁷ SUN Peng, The Indispensability of Civil Rights and Capacity for Civil Rights, 30-31.
⁸ Ibid, 32.
⁹ CAI Hui/WANG Ruifeng, 87-88.

- 4 In contrast to the equal capacity of civil rights, each natural person's capacity for carrying out civil conducts varies depending on age, intellectual and mental status. Under the GPCL, there are three levels of capacity for carrying out civil conducts: full capacity, limited capacity, and no capacity.
- 5 In general, a natural person who is 18 years old or older is deemed to have full capacity for carrying out civil conducts and is entitled to carry out civil activities independently.¹⁰ It is worth noting that certain types of civil conducts have a minimum age requirement above 18 years old. For example, in accordance with art. 6 Marriage Law, the minimum age of marriage for a man and a woman is 22 years old and 20 years old, respectively.
- 6 A minor who has reached the age of 10 or a partially mentally ill person only has limited capacity for carrying out civil conducts and is required to obtain a consent from or be represented by their legal representative in respect to any sophisticated civil activity, the understanding of which is beyond their age, intellectual or mental status.¹¹ It has been argued that the age benchmark of 10 years old should be lowered to 7 years old, the entry age for primary school in China.¹²
- 7 A minor younger than 10 years old or a mentally ill person who is unable to identify or understand his/her own conduct, is legally deemed to have no capacity for carrying out civil conducts and is thus required to be represented by and/or receive consent from their legal representative regarding such civil conduct.¹³
- 8 Currently, an adult's capacity for carrying out civil conducts is only restricted in the case of mental illness. Taking into account both the importance of this issue and the difficulty in determining a person's mental status, only a court can declare whether a person is mentally ill and lacks the appropriate level of capacity for carrying out civil conducts.¹⁴ Some scholars also recommend that a similar restriction be placed on

¹⁰ Art. 11 GPCL. A natural person who is between 16 years old and (but excluding) 18 years old and supports his/her living mainly by his/her own working income is also deemed to have full capacity for carrying out civil conducts.

¹¹ Arts. 12 and 13 GPCL.

¹² *Liu Kaixiang*, 113.

¹³ Arts. 12 and 13 GPCL.

¹⁴ Art. 19 GPCL. A court should determine whether a person has mental illness based on forensic psychiatry evaluation or a physician's diagnosis. If it is impossible to obtain the above described diagnosis or evaluation, the court may make the determination based on the mental status of that person commonly accepted by the public provided that there is no objection from any interested party to that person. Art. 7 of the Opinions on GPCL.

an adult's capacity rights when said adult is addicted to gambling, alcohol, and/or drugs.¹⁵

The level of capacity for carrying out civil conducts is crucial in determining whether a specific civil conduct has been duly carried out. For example, a contract signed by a person with no civil capacity is likely to be void unless he/she was appropriately represented by a legal representative. However, if a person who has no or limited civil capacity accepts rewards or gifts, such conduct is not deemed invalid only due to the fact that such a people lack the capacity.¹⁶ Art. 47 CL makes it clear that a contract entered into by a person with limited capacity for carrying out civil conducts purely for his/her benefit is a valid contract and does not require subsequent ratification by a legal representative. In the context of art. 47 Contract Law, benefit refers to benefits in economic terms.

It is important to understand what civil conducts are appropriate for a person with limited capacity to deal with independently since according to art. 47 Contract Law, such permitted conduct is also valid without the ratification by a legal representative. According to arts. 3 and 4 of the Opinions on GPCL, whether a civil activity is appropriate for a person with limited capacity to deal with independently needs to be analysed based on (i) the extent to which the conduct is connected to that person's daily life and on (ii) whether the conduct itself, its consequence, the value of the matter at hand and other issues can be understood by that person. For example, the use of pocket money by a teenager should be interpreted as appropriate conduct.¹⁷

2. Legal Person

There are two types of legal persons under the GPCL: (i) enterprise legal person; and (ii) governmental organisation, public institution¹⁸, privately-run non-enterprise institution¹⁹, foundation²⁰ or social association²¹ legal person.²² The concept, "legal

¹⁵ *Li Jianhua*, 19-20.

¹⁶ Art. 6 of the Opinions on GPCL.

¹⁷ *LIANG Huixing*, 105–106.

¹⁸ A public institution legal person means a social service organisation established by a state authority or any other organisations with state-owned assets for activities relating to education, science and technology, culture, health and so on. Art. 2 of the Interim Regulations on Registration and Administration of Institutions.

¹⁹ A privately-run non-enterprise institution means a non-profit social service organization established by an enterprise, community association, or any other social organizations or individual without the use of state-owned assets. Furthermore, depending on the structure and way of sharing civil liabilities of a privately-run non-enterprise institution, it is registered as a privately-run non-enterprise institution (legal

person", used to be a controversial topic in China since it touches on the basic principle of operating a state-owned enterprise. It was argued that the inefficiency of state-owned enterprises is caused by lack of independent legal status.²³ The separation of the ownership and the right to manage and operate a state-owned enterprise has since become a key research concept of Chinese civil law scholars.²⁴ The new concept "enterprise legal person" was even created by Chinese civil law scholars.²⁵

- 12** Art. 37 GPCL sets out four minimum requirements of a legal person: (1) it is set up in accordance with the law; (2) it has the necessary assets or funds;²⁶ (3) it has its name, necessary organization, and the premise; (4) it is able to assume civil liabilities independently.
- 13** Compared with the rules regarding a natural person, the rules regarding legal persons have been further amended and developed significantly during the past 30 years.²⁷ It is clear under Chinese law that a legal person has the independent capacity of civil rights and the capacity for carrying out civil conducts.²⁸ A legal person also has the independent capacity to be responsible for losses incurred. However, under art. 20 Company Law²⁹, if a shareholder of a company abuses the rules of the legal person's independent status and shareholder's limited liability and as a result evades debts owed to creditors of that company, that shareholder may be held jointly liable for the resulting debt.

person), a privately-run non-enterprise institution (partnership) or a privately-run non-enterprise institution (individual). Art. 2 and 12 of the Provisional Regulations for the Registration and Administration of Privately-Run Non-Enterprise Institutions.

²⁰ A foundation refers to a non-profit legal person established for the public welfare in accordance with the Regulations on Foundation Administration using assets donated by natural persons, legal persons and/or other organisations. Article 2 of the Regulations on Foundation Administration.

²¹ A social association refers to a non-profit-making social organizations voluntarily set up by Chinese citizens to perform activities in accordance with the articles of association for the realization of the common goals of the members. Art. 2 of the Regulations on Registration and Administration of Associations.

²² Arts. 41 and 50 GPCL.

²³ *XUE Hong*, 58.

²⁴ *RAN Hao/DU Lihong*, 70.

²⁵ *LIANG Huixing*, 124.

²⁶ There is also a specific minimum fund required for certain types of non-enterprise legal persons. For example, a national society association legal person needs to have at least RMB 100,000 and a local society association legal person needs to have at least RMB 30,000 to cover event organising costs. Art. 10 of the Regulations on Registration and Administration of Associations.

²⁷ *YANG Lixin*, 105.

²⁸ Art. 36 GPCL.

²⁹ 公司法, promulgated on 29th December, 1993 and effective from 1st July, 1994, last revised on 27th October 2005 und effective from 1st January 2006.

In China, the common view held by scholars differentiates a legal person's civil right capacity from that of a natural person since (i) a legal person is unable to enjoy certain civil rights of a natural person, e.g. inheritance rights and adoption rights; and (ii) the capacity of a legal person's civil rights is restricted by law and its overall objectives.³⁰ This general view however is criticised on the grounds that there are also restrictions imposed on a natural person's civil right capacity.³¹ 14

Unlike a natural person, there is not a different level of capacity for carrying out civil conducts applicable to a legal person. The opinion on whether there should be any restriction imposed on a legal person's capacity for carrying out civil conducts has changed gradually. The common practice used to be that any conduct carried out by a legal person is invalid if it is outside the scope of business set out in its constitutional documents or its business license, issued by authority.³² Currently, in order to protect the certainty of business transactions, a conduct carried out by a legal person, outside its scope of business, is regarded as the legal person's conduct rather than the conduct of the individual acting on behalf of the legal person.³³ 15

A legal person's capacity for civil rights and its capacity for carrying out civil conducts start when a legal person is established and end when a legal person is dissolved.³⁴ To determine the precise time when a legal person is established, the key reference point is when the set-up of the legal person has been registered with and approved by (if applicable) the relevant governmental authority. Different types of legal persons need to apply for set-up registration with different types of governmental authorities. In general, an enterprise legal person should register with the relevant office of the State Administration of Industry and Commerce (**SAIC**).³⁵ A privately-run non-enterprise institution, a foundation or a social association legal person should register with the Ministry of Civil Affairs or its local counterparts.³⁶ 16

With respect to an enterprise legal person, it will obtain the independent capacity

³⁰ *Li Yunbo*, 40.

³¹ *Ibid.*, 41.

³² *Yang Lixin*, 107.

³³ *Ibid.* For a more detailed analysis on this subject, please refer to the discussion in Chapter 2, Part II (3) (*The Ultra Vires Doctrine*) of Chinese Business Law.

³⁴ *Yang Lixin*, 107.

³⁵ *Liu Kaixiang*, 200.

³⁶ Art. 5 of the Provisional Regulations for the Registration and Administration of Privately-Run Non-Enterprise Institutions, art. 6 of the Regulations on Foundation Administration, and art. 6 of the Regulations on Registration and Administration of Associations.

when it is duly registered with and approved by the relevant office of the SAIC even if its equity capital has not yet been fully paid by its shareholders.³⁷ Governmental organisation legal persons are established upon approval with no need to complete additional registration.³⁸

- 17 For legal persons whose set-up requires registration, the cessation of its legal person's status will only occur when the registration has been cancelled.³⁹ It is important to note the difference between a company's business license and its registration. Even if a company's business licence is revoked by the SAIC or any of its local offices, the company still has the independent legal capacity to participate in the court hearing until it has been formally dissolved.⁴⁰

3. Individual Business, Rural Lease-Based House-Holding Business, and Individual Partnership

- 18 Individual businesses, rural lease-based house-holding businesses and individual partnerships may also carry out civil conducts under their own name.⁴¹ However, the key point to note is that under current Chinese law they do not have independent legal person status.
- 19 An individual business means a business owned and operated by an individual person or a family registered and approved in accordance with the law.⁴² Detailed registration procedures are provided by the Provisions on the Registration Management of Individual Industrial and Commercial Households⁴³ issued by the SAIC.

³⁷ *Shanghai Huifa Construction and Installation Engineering Co., Ltd. v Shanghai Nanhui Agricultural Information Center and Lu Yefu* in respect of a dispute over the repayment of funds (上海汇发建筑安装工程有限公司与上海市南汇区农业信息中心、陆野富返还钱款纠纷案), judgement of the Shanghai First Intermediate People's Court dated 23rd May, 2003.

³⁸ *Liu Kaixiang*, 200.

³⁹ *Ibid.*

⁴⁰ *Guangxi Beisheng Group Co., Ltd v Beihai Weihao Real Estate Development Co., Ltd and Beihai Animal Byproducts Import and Export Co.,Ltd of the Guangxi Zhuang Autonomous Region* in respect of a dispute over a transfer contract of land-use rights (广西北生集团有限责任公司与北海市威豪房地产开发公司、广西壮族自治区畜产进出口北海公司土地使用权转让合同纠纷案), judgement of the SPC dated 2nd June, 2006.

⁴¹ An area which has not been addressed in the General Principles of Civil Law but will hopefully be covered in the civil code is the "non-legal person social associations". *YANG Tao*, 190.

⁴² Art. 26 GPCL.

⁴³ 个体工商户登记管理办法, promulgated on 30th September, 2011 and effective from 1st November, 2011.

A rural lease-based house-holding business (**house-holding business**) refers to a 20 member of a rural collective economic organisation which engages in the scope of business permitted by law.⁴⁴ Under art. 22 of the Law on the Contracting of Rural Land⁴⁵, a house-holding business is established once the relevant lease document is signed, since no registration is required.

If the business suffers any loss, the individual at fault is required to pay the debts by 21 using his/her own individual assets.⁴⁶ Since the business can be owned by either an individual or a family, even if the business is registered only under one family member's name, the family assets may still be seized to repay the business loss provided that family assets have been used to invest in the business or that proceeds from the business are shared among the family members.⁴⁷

The basic concept of partnership is set out in art. 30 GPCL: natural persons may 22 contribute funds, material, technology, and/or other resources to a partnership and thus manage the partnership jointly. Not all partners of a partnership need to be involved in daily management and each partner's initial equity contribution to the partnership can be made in different forms.⁴⁸ The key issue is whether the partners share the risks of the business or not.⁴⁹ According to art. 50 of the Opinions on GPCL, the existence of a partnership may still be upheld by the court even when there is no formal written partnership agreement and the required legal registration with the SAIC has not been made.

In general, under art. 35 GPCL, partners assume joint and several liability for the 23 debts incurred by the partnership, except as otherwise specified by the law. In the event that the partnership does not have sufficient assets to repay its debts, the partners are responsible for the repayment of the debts out of their own assets. A partner has the right to claim recovery from other partners when the amount of the repayment he/she has made exceeds the amount he/she should have undertaken.⁵⁰

⁴⁴ Art. 27 GPCL.

⁴⁵ 农村土地承包法, promulgated on 29th August, 2002, and effective from March 1, 2003, last amended on 27th August, 2009

⁴⁶ Art. 29 GPCL.

⁴⁷ Art. 42 of the Opinions on GPCL.

⁴⁸ Art. 46 of the Opinions on GPCL.

⁴⁹ Under art. 34 GPCL, all partners shall bear civil liability for the business activities of the managing partner and other personnel.

⁵⁰ Art. 35 GPCL.

- 24** More detailed rules regarding partnership enterprise are set out in the Partnership Enterprise Law⁵¹. Apart from the normal partnership described in the GPCL, the amended Partnership Enterprise Law also allows limited partnership. Similar to other jurisdictions which permit limited partnership, under the Partnership Enterprise Law, the main difference between a normal partnership and a limited partnership is that some partners of a limited partnership are limited partners who only bear limited liability with respect to losses incurred by the partnership up to the amount of the limited partner's committed equity contribution to the partnership.⁵²
- 25** As a result of the rapid development of the service industry in China, the Partnership Enterprise Law creates a special type of partnership, suitable for service firms such as an accountant or law firm.⁵³ Pursuant to art. 57 Partnership Enterprise Law, regarding any loss incurred by the special partnership caused by one or a number of partners' wilful misconduct or gross negligence, only those responsible partners bear unlimited liabilities while other partners' liabilities are capped at their equity contribution to the partnership.⁵⁴

II. Legal Representative

- 26** For a legal person, the concept of a legal representative is particularly important under Chinese law. Some experts hold the view that the legal representative of a legal person is a unique concept created under Chinese law.⁵⁵ A legal representative of a legal person means the natural person who is entitled to assume rights and responsibilities on behalf of that legal person in accordance with the law or the articles of association of that legal person.⁵⁶ In practice, the chief executive or chairman of a legal person will act as its legal representative. It is also worth noting that, despite the debate among legal scholars, there is normally only one legal representative for each legal person.⁵⁷

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⁵¹ 合伙企业法, promulgated on 23rd February, 1997 and effective from 1st August, 1997.

⁵² Art. 2 of the Partnership Enterprise Law.

⁵³ Arts. 55 to 59 of the Partnership Enterprise Law.

⁵⁴ For a more detailed analysis of the relevant provisions on this subject, please refer to the discussion in Chapter 2, Part III (*Main Issues Regarding Partnership Enterprises*) of *Bu Yuanshi* (ed.), 18-20.

⁵⁵ *Liu Kaixiang*, 219.

⁵⁶ Art. 38 GPCL.

⁵⁷ *Liu Kaixiang*, 220-221.

However, the power of the legal representative is not unlimited. The legal representative has to act for the benefit of the legal person and in accordance with the articles of association of that legal person.⁵⁸ Furthermore, under Chinese law, both an enterprise legal person and its legal representative may be subject to fines, administrative punishment and/or criminal liability in the following events: (1) engaging in an illegal business operation outside the enterprise's registered business scope, approved by the relevant authority; (2) concealing facts from registration and tax authorities; (3) withdrawing capital or concealing property for evading debt repayment; (4) disposing of any property without authorisation after the enterprise is dissolved or declared bankrupt; (5) failing to apply for registration and failing to make a public announcement immediately when a major event occurs to which results in material losses for the enterprise; or (6) engaging in other activities prohibited by the law, which damage the interests of the state or the public.⁵⁹ The fine that is imposed on a legal representative directly is generally not more than RMB 2,000, unless otherwise specified in the law.⁶⁰

III. Agency

1. Types of Agency

Similar to most other jurisdictions, Chinese civil law allows an agent to carry out civil activity on behalf of its principal. However, if the principal is required to perform the activity by himself/herself, either by law or as agreed upon by the relevant parties, then any conduct carried out by the agent is invalid.⁶¹ Furthermore, if there were to be a potential conflict of interest between the agent and the principal, the agent would be prohibited from accepting any agency authorisation. For example, in the case of *Liu Xinglin v Haigang Rural Credit Cooperative*, regarding a dispute over deposits,⁶² the Hebei High Court held that the head of the Haigang Rural Credit

⁵⁸ *Shanghai Huifa Construction and Installation Engineering Co., Ltd v Shanghai Nanhui Agricultural Information Center and Lu Yefu* (上海汇发建筑安装工程有限公司与上海市南汇区农业信息中心、陆野富返还钱款纠纷案) in respect of a dispute on repayment of funds.

⁵⁹ Arts. 49 and 134 GPCL; Art. 61 of the Opinions on GPCL.

⁶⁰ Art. 63 of the Opinions on GPCL.

⁶¹ Art. 63 GPCL and art. 78 of the Opinions on GPCL. For example, under art. 8 Marriage Law, the bride and groom must apply for the marriage registration in person.

⁶² *Liu Xinglin v Haigang Rural Credit Cooperative* in respect of a dispute over deposits (刘杏林与海港农村信用合作社存款纠纷案), judgement of the High People's Court of Hebei Province dated 26th April, 2001.

Cooperative was prohibited from also acting as the agent of Mr Liu Xinglin in respect of Mr Liu's deposit at the Haigang Rural Credit Cooperative.

29

In general, an agent is required to carry out civil conducts on behalf of the principal in accordance with the authorisation.⁶³ Art. 64 GPCL sets out three types of agency: (i) authorised agency; (ii) statutory agency; and (iii) designated agency. An authorised agent should exercise power as authorised by the principal; a statutory agent should exercise the power in accordance with the law; and a designated agent should exercise the power of agency as designated by a court or the relevant designating organization.⁶⁴

30 In general, it is possible to authorise an agent by either oral or written instructions.⁶⁵

However, sometimes a written authorisation is mandatory as required by law. A written authorisation needs to provide the agent's name, the subject of the authorised matter, duration of the authorization, and should be signed or stamped by the principal.⁶⁶

31 An agent and its principal may also assume joint and several liability and may therefore be sued jointly as co-defendants in a civil litigation.⁶⁷ For instance, if an agent or its principal is aware of the illegality of the subject matter but still carries out or does not object to the civil conducts, then the agent and the principal are both responsible for the relevant liabilities.⁶⁸ If the agent has not duly performed his or her obligations as owed to the principal, the agent should be responsible for compensating the principal.⁶⁹

2. Unauthorised Agency and Agency by Estoppel

32 The GPCL only includes the general concept of unauthorised agency.⁷⁰ Under the GPCL, if an act of the agent is neither authorised nor consequently approved by the

⁶³ Art. 63 GPCL.

⁶⁴ Art. 64 GPCL.

⁶⁵ Art. 65 GPCL.

⁶⁶ Art. 65 GPCL.

⁶⁷ Art. 83 of the Opinions on GPCL.

⁶⁸ Art. 67 GPCL.

⁶⁹ Art. 66 GPCL.

⁷⁰ *LIANG Huixing*, 240 - 241.

principal⁷¹, then the act is not binding and the agent is liable for the consequence of the act.⁷² However, in order to protect the interests of a good faith third party, if the original authorisation by the principal has not clearly set out the details of the authorised matter, the principal is still liable to the third party for the act carried out by the agent, of which the agent is jointly responsible.⁷³ Regarding an agreement between an unauthorised agent and a third party, unless the principal confirmed the agent's conduct, the agreement does not bind the principal.⁷⁴ However, the third party is entitled to request the principal to verify the agreement within one month⁷⁵ and a *bona fide* third party has the right to rescind the agreement before it is verified by the principal.⁷⁶

As further development, the later enacted Contract Law also sets out specific rules **33** for the agency by estoppel. Similar to other types of unauthorised agency, in the case of agency by estoppel, the alleged agent is not duly authorised by the principal, but a *bona fide* third party has reasons to believe that the alleged agent is duly authorised, then pursuant to art. 49 CL, any related conduct carried out by the agent is still valid. However, if the third party has acted negligently and failed to verify the alleged agency authorisation, then agency by estoppel is unlikely to be upheld by the court.⁷⁷

During the legislation process of the Contract Law, how to regulate the agency by **34** estoppel, was heatedly debated.⁷⁸ One group supported a single condition approach: Whether the *bona fide* third party has reasons to believe that the agent is duly authorised is based on existing facts. While the other group preferred a two

⁷¹ If the principal is aware of the act and does not expressly object to it, then the principal will be deemed to have approved the act. Art. 66 GPCL.

⁷² Art. 66 GPCL; art. 48 CL.

⁷³ Some scholars argue that it seems unfair that the agent is jointly responsible in this scenario. Some scholars distinguish a paid agency role with an unpaid agency role and hold the view that only a paid agent should be jointly responsible provided that its own gross negligence caused the ambiguous authorisation. YANG Lixin, 111.

⁷⁴ Art. 48 CL.

⁷⁵ The principal will be deemed to have refused to approve the agreement if the principal fails to respond within one month. Art. 48 CL.

⁷⁶ Art. 48 CL.

⁷⁷ Hefei Eastern Real Estate Development Ltd. v High Hope Int'l Group Jiangsu Native Produce Import and Export Co., Ltd., Hefei Huawei Economic Development Co., Ltd. and Hefei Huafeng Livestock and Poultry Economic Development Ltd. in respect of a dispute of a contract to transfer debt obligations and pre-sell commercial housing) (合肥东方房地产开发有限公司与江苏汇鸿国际集团土产进出口股份有限公司、合肥华侨经济开发公司、合肥华丰畜禽经济开发有限责任公司债务转让、商品房预售合同纠纷案), judgement of the SPC dated 31st July, 2001.

⁷⁸ YIN Tian, 115-116.

conditions approach: Not only the *bona fide* third party must have reasons to believe the authorisation, the principal must also have acted negligently to cause the third party to believe that the principal has duly authorised the agent.⁷⁹

- 35** Based on a strict interpretation of art. 49 CL, the single condition approach seems to be adopted by the Contract Law. However, some scholars continue to challenge this interpretation and propose to adopt the two conditions approach on the grounds that it seems unfair to request the principal to take full responsibility if the principal has not been negligent.⁸⁰ Some Chinese civil law textbooks also state that if the principal has not acted negligently, the *bona fide* third party is not entitled to claim agency by estoppel.⁸¹
- 36** In practice, a legitimate reason, on which the *bona fide* third party is entitled to rely, is normally a certain relationship between the agent and the principal. For example, under art. 50 CL, if the legal representative, chief executive of a legal person, or other type of organisations enters into an agreement with a third party beyond his or her internal authority, unless the relevant third party is aware of that fact, the corresponding conduct of the representative is valid.
- 37** Currently, no discretion is given to transaction parties to decide whether an agreement, entered into under agency by estoppel, should be void. Many legal scholars hold the view that the *bona fide* third party, instead of the principal, should have the right to choose whether or not to claim the relevant conducts carried out by the agent as void, i. e. a general type of unauthorised agency; or as valid, i.e. an agency by estoppel.⁸² Given that arts. 47 and 48 CL allow the relevant transaction counterparty to rescind an agreement entered into with an unauthorised agent before it has been ratified by the principal, it seems unfair that in the case of agency by estoppel, a *bona fide* third party does not have the same right to rescission.⁸³

3. Indirect Agency

- 38** Direct agency arrangement means that the agent carries out a civil conduct using the principal's name and the principal automatically bears the consequences of the

⁷⁹ Ibid, 115.

⁸⁰ XU Liwen, 74-75; YE Jinqiang, 111.

⁸¹ LIU Kaixiang, 366.

⁸² DONG Xueli, 63-64; LIU Kaixiang, 366.

⁸³ DONG Xueli, 64.

civil conduct. In contrast, under an indirect agency arrangement, the agent uses its own name to carry out civil conducts and is responsible for the legal consequences of those conducts until the agent transfers the relevant gains or losses back to the principal.⁸⁴ It is widely agreed that the general agency rules set out in the GPCL only regulate direct agency arrangements, while arts. 402 and 403 CL provide the legal basis for indirect agency arrangements.⁸⁵

Under art. 402 CL, an agent is permitted to enter into a contract with a third party **39** under the agent's own name. If the third party is aware of the agency relationship between the agent and the principal, then the contract binds the third party and the principal directly.⁸⁶ Scholars have argued that art. 402 CL is similar to the "agent of an unnamed principal" rule under common law jurisdictions: The third party is aware of the agency authorisation, but not the name of the principal.⁸⁷

Art. 403 CL further states that if the third party is not aware of the agency **40** relationship when entering into the agreement with the agent and the third party fails to perform its contractual obligations, the agent should disclose the identity of the third party to the principal. The principal may then directly request the third party to perform the relevant contractual obligations unless that third party would have refused to sign the agreement had it been aware of the agency relationship between the agent and the principal.⁸⁸ Similarly, under art. 403 CL, if the agent fails to perform the relevant contractual obligations, due acts of the principal, the agent should then disclose the identity of the principal to the third party, after which the third party is entitled to bring claims against either the agent or the principal.⁸⁹ Some scholars believe that art. 403 CL sets out the "agent of an undisclosed principal" rule under common law jurisdictions:⁹⁰ The third party is neither aware of the agency authorisation nor the name of the principal.

⁸⁴ *LIANG Huixing*, 229.

⁸⁵ *Ibid*, 230.

⁸⁶ Art. 402 CL.

⁸⁷ *Wu Qinwang*, 157-158.

⁸⁸ Art. 403 CL.

⁸⁹ Under art. 403 CL, the third party is not permitted to change its choice.

⁹⁰ *Wu Qinwang*, 157-158.

4. Delegation of Agency

- 41** If an authorised agent wants to delegate the agency authorisation to another person in the interests of the principal, the consent of the principal should be obtained in advance.⁹¹ In the event that the consent of the principal is not obtained in advance, the authorised agent needs to inform the principal of the delegation as soon as possible thereafter. If the principal does not agree to such delegation, then the agent is responsible for the conducts of the transferee, except when the agency arrangement is delegated to a third party in emergency circumstances in order to protect the interests of the principal.⁹² For example, if the agent suddenly becomes ill and due to technical reasons unable to consult the principal in time, the agent is then entitled to authorise a third party to assume its agency responsibilities in order to protect the interests of the principal.⁹³
- 42** Furthermore, when delegating the agency authorisation to another person, the initially authorised agent needs to follow the required formalities set out in art. 65 GPCL.⁹⁴ If the original agent fails to delegate the agency properly, resulting in losses by a third party, then the third party may directly bring a claim against the principal.⁹⁵ The principal may then ask the original agent as well as the new agent (to the extent of loss caused by that new agent) to reimburse the relevant losses incurred by the principal.⁹⁶

5. Termination

- 43** According to art. 69 GPCL, an authorised agency relationship will terminate when: (1) the duration of the agency expires or the relevant subject matter for the agency relationship is completed; (2) the principal or the agent terminates the agency relationship⁹⁷; (3) the agent dies; (4) the agent ceases to have full capacity for

⁹¹ Art. 68 GPCL.

⁹² Art. 68 GPCL.

⁹³ Art. 80 of the Opinions on GPCL.

⁹⁴ Art. 81 of the Opinions on GPCL.

⁹⁵ Ibid.

⁹⁶ Ibid.

⁹⁷ It is clear that a principal can terminate the agency relationship unilaterally. Reply of the People's Bank of China on Whether Insurance Companies are Entitled to Unilaterally Terminate the Principal-Agent Relationship with Insurance Agents (中国人民银行关于保险公司是否有权单方终止与保险代理人委托代理关系的答复), promulgated on and effective from 8th April, 1997.

carrying out civil conducts; or (5) when the legal person acting as the principal or the agent is dissolved.

Nevertheless, the agency relationship may still survive after the death of the **44** principal if: (1) the agent does not know about the death of the principal; (2) the successor of the principal approves the acts; (3) the principal and the agent previously agreed that the authorisation will be terminated upon completion of the subject matters; or (4) the civil activity has started before the death of the principal and continues in favour of the successor following the death of the principal.⁹⁸

A statutory or designated agency arrangement will be terminated when: (1) the **45** principal obtains or regains the full capacity for carrying out civil conducts independently; (2) the principal or the agent dies; (3) the agent loses independent capacity for carrying out civil conduct; (4) the court or the organization that designated the agent subsequently terminates the designation; or (5) the guardianship between the principal and the agent is extinguished for any other reasons.⁹⁹

⁹⁸ Art. 82 of the Opinions on GPCL.

⁹⁹ Art. 70 GPCL.

Chapter 3. Statute of Limitations

Literature: *HAN Song* (韩松)/*JIAO Heping* (焦和平), The Analysis and Re-structure of the Rules set out in the GPCL to Interrupt the Period of Limitation of Actions by Claim Submission to the Court (对我国《民法通则》关于起诉引起诉讼时效中断规定的反思与重构), *Legal Forum* (法学论坛) 2006, No. 5, 73-79. *Li Chun* (李春), The Debate and Resolutions in respect of the Period of Limitation of Actions for Invalid Contracts (无效合同诉讼时效问题的论争及处理探讨), *Journal of Law Application* (法律适用) 2010, No. 10, 50-53. *Li Yongfeng* (李永锋), The Impact of Court Claim Submission on the Period of Limitation of Actions (起诉对诉讼时效的影响), *Global Law Review* (环球法律评论) 2007, No. 5, 60-67. *Liu Jinwei* (柳经纬), Several Theoretical Issues in respect of Periods of Limitation (关于时效制度的若干理论问题), *Journal of Comparative Law* (比较法研究) 2004, No. 5, 14-30. *Liu Jun* (刘俊), The Dual Value of Limitation – The Deficiency of Limitation System of China (诉讼时效制度的二元价值-兼评我国诉讼时效制度的缺失), *Hebei Law Science* (河北法学) 2007, No. 10, 115-118. *Liu Kaixiang* (刘凯湘), *General Introduction to Civil Law* (3. ed.)(民法总论), Beijing 2011. *WEI Shengli* (魏盛礼), The Model of Absolute Extinguishment of Substantive Right: Our Choice as It ought to Be in Effect of Limitation of Action (完全的实体权利消灭主义: 我国诉讼时效效力立法的应然选择), *Hebei Law Science* (河北法学) 2006, No. 11, 119-124. *YANG Lixin* (杨立新)/*WANG Yi* (王轶)/*WANG Zhu* (王竹)/*WANG Tianfan* (王天凡)/*ZHAO Ke* (赵可), *The Thirty Years of Chinese Civil Law* (中国民法三十年), Beijing 2008. *YU Dongai* (余冬爱), The Legal Analysis and Judicial Implementation of Statue of Limitations (诉讼时效法定性的法理解析与司法适用), *Journal of Law Application* (法律适用) 2008, No. 11, 23-25.

I. General Provision

- 1 Under current Chinese law, a statute of limitations refers to the period during which a citizen or a legal person is entitled to submit a claim to the court to enforce their civil rights.¹ If the relevant period of limitation of actions expires and there is no suspension, interruption, or extension of the period of limitation, then claims submitted after the expiry date will not be supported by the court.

1. Legal Nature

- 2 However, it is the defendant's responsibility to establish that the relevant period of limitation has already expired. The court will not accept the argument if the

¹ Chapter 7 GPCL.

defendant fails to prove it.² Furthermore, if no party has submitted a defence in respect of a period of limitation, the court is prohibited from raising this point *ex officio*.³ This reflects a recent development in China to transfer the court's role in civil case hearing from an active and dominant one to a more passive one. The parties' autonomy under civil law is also protected. Previously, in accordance with art. 153 of Opinions of SPC on Certain Issues Regarding the Implementation of the Civil Procedure Law of the People's Republic of China⁴, when the court accepted a new case, submitted after the relevant period of limitation expires, the court would check to see first whether there was any reason for suspension, interruption or extension of the period of limitation and reject the claim if no such circumstance existed. Many Chinese scholars have commented that the previous approach originates from a copy of rules set out in the Civil Code of the Soviet Union, which are only suitable for a planned economy.⁵

It is clear that under Chinese civil law, in general, the effect of a statute of limitations 3 is to restrict a claimant's rights to enforce a claim before the court rather than to eliminate the claimant's underlying civil rights. For example, if after the relevant period of limitation expires, the counterparty voluntarily decides to fulfil his/her obligation or complies with the claimant's request, then such conduct is still valid.⁶

If the parties agree upon a repayment plan of the original debt after the expiry of the 4 period of limitation, then the creditor will regain his/her right to bring a claim to the court to enforce the original debt and a new period of limitation of actions will start.⁷ In practice, if after the expiry of the period of limitation, a creditor sends a debtor an outstanding payment notice and the debtor has signed or stamped the notice, then a new period of limitation of actions for the outstanding debts will be deemed to have

² *Peng Jiahui v Chinese Story* in respect of a dispute over reputation right (彭家惠与《中国故事》杂志社名誉权纠纷案), judgement of the High People's Court of Sichuan Province dated 22nd August, 2002.

³ Art. 3 of the Rules of the SPC on Certain Issues Concerning the Implementation of Periods of Limitation in Civil Litigation (最高人民法院关于审理民事案件适用诉讼时效制度若干问题的规定), promulgated on 21st August, 2008 and effective from 1st September, 2008 (hereinafter: Rules on Periods of Limitation).

⁴ (最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见), promulgated on and effective from 14th July, 1992.

⁵ *Wei Shengli*, 122.

⁶ Art. 138 GPCL; para. 22 of the Rules on Periods of Limitation.

⁷ Reply of the SPC on Whether a Repayment Agreement Agreed by the Parties after the Expiry of the Period of Limitation of Actions Should be Protected by Law (最高人民法院关于超过诉讼时效期间当事人达成的还款协议是否应当受法律保护问题的批复), promulgated on and effective from 16th April, 1997.

re-started.⁸ The debtor's act to sign or stamp the notice is deemed as a waiver of the available defence that the period of limitation of actions has passed.⁹ Furthermore, if the debtor voluntarily confirms the original debt to the creditor after the expiry of the period of limitation, it will result in the same consequence of which the creditor will regain the right to bring a claim to the court in order to enforce the original debt.¹⁰

- 5 The defence regarding the period of limitation must be raised during the trial of first instance. The second instance court will not support that party's defence based on the period of limitation unless it can be proved by newly obtained evidence.¹¹ According to art. 41 of the Some Provisions of the SPC on Evidence in Civil Procedure¹², a piece of evidence is regarded as newly obtained in the trial of second instance if (i) the evidence is obtained after the end of the trial of first instance; or (ii) the evidence is obtained after the second instance court permits the party's application for court evidence investigation previously rejected by the first instance court.

2. Scope of Application

- 6 In China, the development of a statute of limitations is driven by the legislation and development of the Real Rights Law.¹³ However, it has not been generally agreed whether the statute of limitations should also apply to property rights, which reflect different priorities in protecting the legal rights of the original property owner against the interests of *bona fide* third parties.¹⁴ There is also a compromised view that only

⁸ Reply of the SPC on the Legal Consequence of a Signature or Seal Affixed by a Borrower to a Notice Demanding Payment on a Loan after the Expiry of the Period of Limitation of Actions (最高人民法院关于超过诉讼时效期间借款人在催款通知单上签字或者盖章的法律效力问题的批复), promulgated on 11th February, 1999 and effective from 16th February, 1999.

⁹ *China Oriental Assets Management Ltd., Dalian Office v Liaoning Huaxi Group Ltd.* in respect of a dispute of security provided for a loan agreement (中国东方资产管理公司大连办事处与辽宁华曦集团公司等借款担保纠纷案), Judgement of the SPC dated 28th August.

¹⁰ Reply of the SPC on Whether Sending a Letter Confirming Outstanding Debts to the Creditor by the Debtor after the Expiry of the Period of Limitation of Actions Constitutes a New Debt (最高人民法院关于超过诉讼时效期间后债务人向债权人发出确认债务的询证函的行为是否构成新的债务的请示的答复), promulgated on and effective from 4th June, 2004.

¹¹ Art. 4 of the Rules on Periods of Limitation.

¹² 最高人民法院关于民事诉讼证据的若干规定, promulgated by the SPC on 21st December, 2001 and effective from 1st April, 2002.

¹³ YANG Lixin, 111-112.

¹⁴ Ibid.

certain types of real rights should be subject to a statute of limitations.¹⁵ In the draft civil code published in 2002 by the NPC, art. 105 sets out a 5-year period of acquisitive prescription for real estate and art. 106 sets out a two-year period of acquisitive prescription for movable properties.¹⁶

It is worth noting that the restriction on the period of limitation does not apply to the 7 protection of any state's assets which have not been authorised to any individual or legal person for operation or management.¹⁷ Furthermore, the SPC has clarified that the period of limitation is not applicable to: (i) claims relating to the principal amount of deposits and related interest payments; (ii) claims relating to the principal amount of treasury bonds, financial bonds, corporate bonds, and related interest payments; (iii) claims relating to unpaid committed equity investment; and (iv) other types of debt claims which are not subject to a period of limitation as set out by the law.¹⁸ According to the SPC, the claims described in (i) and (ii) above relate to the protection of general public interests. The restriction on the application of a period of limitation will help to protect personal interests of each individual depositor or investor.¹⁹ Regarding claims described in (iii) above, if the period of limitation were applicable, it would be inconsistent with the principle of *company capital adequacy* and have adverse effect on protecting the interest of a company's creditors and other shareholders who have fully paid their committed equity investment.²⁰

3. Statute of Limitation, Cut-off Period and Laches Defence

The statute of limitations needs to be distinguished from the cut-off period, and the 8 laches defence. The statute of limitations is generally applicable to the right of claim, whereas the cut-off period is normally applicable to the right of formation. The cut-off period differs from the statute of limitations in that no suspension, interruption, or extension is available to the cut-off period. An example of a cut-off period is the time limit imposed on the right to rescind a contract.²¹ Under art. 55 Contract Law, in

¹⁵ Ibid.

¹⁶ *Liu Jinwei*, 16-17.

¹⁷ Art. 170 of the Opinions on GPCL.

¹⁸ Art. 1 of the Rules on Periods of Limitation.

¹⁹ Interview of the SPC by the People's Court Daily concerning the Rules of the SPC on Certain Issues Concerning the Implementation of Periods of Limitation in Civil Litigation http://www.china.com.cn/policy/txt/2008-09/01/content_16366877_2.htm.

²⁰ Ibid.

²¹ *Liu Kaixiang*, 381-382; art. 7 of the Rules on Periods of Limitation.

respect of a voidable contract, a party's right to rescind will be extinguished if that party does not exercise the right to rescind within one year from the date when party is aware of, or should be aware of, the reason for rescission. The general period of limitation of actions is not applicable to a party's right to rescind a voidable contract.²²

- 9 Laches defence refers to when the claimant has unreasonably delayed claiming the relevant rights and as a result the defendant's interests are negatively affected; the court may then partially or fully reject the claimant's claim.

II. Period of Limitation

- 10 In accordance with art. 135 GPCL, the period of limitation of actions is generally two years. Unless the law specifies otherwise, this set period of limitation applies.²³ For example, under art. 265 Maritime Law²⁴, the period of limitation for environmental damage claims is three years.
- 11 Since China traditionally does not have a pro-litigation culture, the normal two-year limitation period has been criticised by legal experts for being too short. One scholar has pointed out that the two-year period might be the shortest period of limitation of actions in the world.²⁵ It was also argued that in practice many debtors took advantage of the short period of limitation as a way of evading debts.²⁶
- 12 The two-year period of limitation is also applicable for claiming damages caused by defective products. The calculation of the period begins when the relevant party finds out, or should have become aware of, the product's defect. However, unless there is an express product warranty period which is longer than ten years, a general long-stop date for bringing claims on defective products is ten years after the date on which the relevant product was delivered.²⁷ A one-year period of limitation is applicable for (i) personal injury claims, (ii) sales of defective goods without declaration, (iii) rent payment issues, or (iv) loss of or damage to assets

²² Art. 7 of the Rules on Periods of Limitation.

²³ Art. 141 GPCL.

²⁴ 海商法, promulgated by SCNPC on 7th November, 1992 and effective from 1st July, 1993.

²⁵ *Liu Jun*, 117.

²⁶ *Ibid*.

²⁷ Art. 45 of the Product Quality Law (产品质量法), promulgated by SCNPC on 22nd February, 1993 and effective from 1st September, 1993.

under custody.²⁸ The reason for such a short period of limitation is to encourage claimants to enforce their rights in time to avoid difficulties in collecting evidence at a later date. However, some scholars have argued in favour of removing the one-year period of limitation on the ground that it is too short to effectively protect the relevant rights.²⁹ In respect of goods delivery by water or by rail, the period of limitation of 180 days is applicable starting from the next day after the shipping records are received.³⁰

It is also important to note that there is a long-stop date of 20 years after the 13 occurrence of the cause of claims regardless of whether the claimant is aware of the relevant claim, unless the court extends the long-stop date under certain circumstances as stated by the law.³¹

For the purpose of clarifying the dates or numbers used in civil laws, art. 155 GPCL 14 provides that "not less than", "not more than", "within", or "expiry" all include the referred figure; and "under" or "beyond" does not include the referred figure. Furthermore, according to art. 154 GPCL, a time period calculated in hours will start from a specified hour, and a time period calculated in days will start from the next day of a specified date.³² If the time period does not start from the first day of a month, "month" will then refer to the following 30-day period and "year" will refer to the following 365-day period.³³

²⁸ Art. 136 GPCL. The purpose to set a one-year period of limitation is to encourage claimants to protect their rights in time and to reduce the difficulties in collecting the relevant evidence; however, such a short period has been criticised by scholars as it may cause negative effects on the protection of the relevant civil rights. *LIANG Huixing*, 255.

²⁹ *LIANG Huixing*, 255.

³⁰ Reply of the SPC on the Claim Period for Transporting Goods by Water (最高人民法院关于水路货物运输中索赔期问题的复函), promulgated on and effective from 8th December, 1988; Interpretation of the SPC on Certain Issues Concerning the Trial of Cases Involving Compensation for Damage in Rail Transportation (最高人民法院关于审理铁路运输损害赔偿案件若干问题的解释), promulgated on and effective from 27th October, 1994.

³¹ Art. 137 GPCL.

³² When the last day of a time period falls during a weekend or other public holiday, the last day will be postponed until the first business day immediately following the holiday. Art. 198 of the Opinions on GPCL.

³³ Art. 198 of the Opinions on GPCL.

III. Commencement, Suspension, Interruption and Extension of a Period of Limitation

1. Commencement

a. General Provision

15 In general, the period of limitation of actions applies from when the relevant party starts to be aware of or should have become aware of the claim.³⁴ The controversial issue in practice is whether the period of limitation should start to count even if the claimant is not aware of the name and address of the relevant defendant. It can be argued however that it should still be applicable since the claimant can still request the counterparty to perform their obligations within the period of limitation by issuing a public announcement.

b. Cause of Action in Tort

16 It is important to understand that, with respect to cause of action in tort, the period of limitation will not start to count until the relevant party becomes aware of, or should have become aware of, the infringement. For instance, where no evidence was available to the defendant to prove that the claimant had already known that the defendant infringed its know-how rights, the SPC held that the period of limitation of actions did not start to count until the claimant became aware of the infringement.³⁵ For personal injury claims, if the injury is obvious and easy to identify, the period of limitation begins from the date of the occurrence of the injury. Otherwise, if the injury is not initially obvious, the period of limitation will start from when a diagnosis is available following examinations provided that there is evidence supporting the causation of the injury by the earlier incident.³⁶

c. Cause of Action in Contract

17 How to calculate the commencement of a period of limitation involving a void contract is still a controversial issue in China. At present, there are five different

³⁴ Art. 137 GPCL.

³⁵ *Luoding Forestry and Chemical Co., Ltd. and Liu Xianchi v Zhuzhou Flotation Reagents Factory* in respect of a dispute over know-how infringement (罗定市林产化工厂、刘显驰与株洲选矿药剂厂技术秘密侵权案), judgement of the SPC dated 9th May, 2000.

³⁶ Art. 168 of the Opinions on GPCL.

suggestions: (1) it starts when the void contract is signed; (2) it starts from the agreed date on which a contract party is obligated to perform his/her contractual obligations; (3) it starts when the contract is held void; (4) it starts from the deadline for satisfying contractual obligations as set out under the void contract; and (5) if both parties enter into the contract in good faith, then the period of limitation starts from the deadline for satisfying contractual obligations as set out under the void contract; however, if one party is initionally aware that the contract is void, then the period of limitation for that party starts from the date on which the contract is signed and the period of limitation for the other party in good faith starts from the moment when the contract is found void.³⁷ Nevertheless, the SPC held in a case that a party's request to determine a contract's invalidity is not subject to the period of the limitation of actions since neither party is entitled to determine whether a contract is valid or not.³⁸ After a contract is found to be void by the court or arbitration tribunal, the law on the limitation of actions will then apply regarding the request for the return of property and compensation for losses.³⁹ This reflects one common view in China, which focuses on the illegality of a void contract. However, it may be argued that the period of limitation should also apply to the right to request a court to determine the validity of a contract because it is important to protect the certainty of legal relations.

Regarding a contract without a specified deadline for performing the obligations, in accordance with article 6 of the Rules on Periods of Limitation, if it is possible to ascertain the deadline of performing the obligations under Contract Law, the period of limitation will start to count from the expiry of the deadline. If it is impossible to ascertain the deadline under the original contract, the period of limitation will start to count from the new deadline requested by the claimant; however, if the debtor expressly refuses to perform his/her contractual obligations, the period of limitation will start to count from the date of refusal.

³⁷ *Li Chun*, 50-51.

³⁸ *Guangxi Beisheng Group Co., Ltd v Beihai Weihao Real Estate Development Company and Beihai Animal Byproducts Import and Export Group of the Guangxi Zhuang Autonomous Region* in respect of a dispute over a transfer contract of land-use rights (广西北生集团有限责任公司与北海市威豪房地产开发公司、广西壮族自治区畜产进出口北海公司土地使用权转让合同纠纷案), judgement of the SPC dated 2nd June, 2006.

³⁹ *Ibid*.

2. Suspension

- 19** Art. 139 GPCL provides that if during the last six months of the applicable period of limitation, the claimant fails to bring a claim as a result of force majeure or other kinds of obstacles, the period of limitation should be suspended until a date when the cause for the suspension ceases to exist. In contrast with civil codes of other jurisdictions such as Germany and Japan, when the period of limitation starts to count again after suspension, no extra period will be added to the remaining period of limitation.⁴⁰ As a result, if the remaining period is too short, the claimant may not have sufficient time to raise his/her claims.⁴¹
- 20** In the GPCL, there is no example given to clarify the meaning of "other kinds of obstacles" mentioned in art. 139. According to art. 172 of the Opinions on GPCL, the absence of a suitable statutory agent for a claimant without capacity or with only limited capacity for carrying out civil conducts may be regarded by the court as "other kinds of obstacles". Art. 20 of the Rules on Periods of Limitation further clarifies that other kinds of obstacles also include: (i) no heir, heiress or estate administrator identified or appointed when the inheritance procedure begins; (ii) when the claimant is prevented by the obligor or another person from claiming the relevant rights; or (iii) when other circumstances prevent the claimant from claiming the relevant rights.⁴²
- 21** According to a judicial interpretation, in respect of a payment guarantee provided by a guarantor to a creditor, if the period of limitation for the underlying debt claim is suspended, the period of limitation for the guarantee claim will also be suspended.⁴³

3. Interruption

a. General Provision

- 22** According to art. 140 GPCL, the calculation of the period of limitation should be discontinued if: (i) the claimant submits a formal claim to the court⁴⁴; (ii) the claimant

⁴⁰ *Liu Kaixiang*, 378.

⁴¹ *Ibid.*

⁴² For example, a debtor runs away to evade the debts and the creditor is therefore unable to claim the relevant rights. *LIANG Huixing*, 257.

⁴³ Art. 36 of the Interpretation of the SPC on the Security Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国担保法》若干问题的解释), promulgated on 8th December, 2000 and effective from 13th December, 2000.

serves a request to the obligor for the performance of duties⁴⁵; or (iii) the obligor agrees to perform the relevant duties⁴⁶.

In contrast with the suspension of the period of limitation, upon the occurrence of the above mentioned events set out in art. 140 GPCL, the calculation of the period of limitation will then re-start.⁴⁷ The period of limitation of action can be re-started more than once if a similar event occurs subsequently.⁴⁸ For instance, when a banker regularly requests the debtor to repay its debts, the relevant period of limitation is then re-started accordingly.⁴⁹ Moreover, even if the creditor only claims the right over a proportion of the relevant debt, the period of the limitation in respect of the whole debt will be re-started, unless the creditor expressly waives claims over the remaining unclaimed debt.⁵⁰

b. Formal Claim to the Court

For the purpose of interruption of statute of limitations, a party may bring a claim to the court, the people's mediation committee, or to another authority, institution or association which has legal authority to resolve disputes.⁵¹ In addition, the SPC clarified that the following events have the same effect as a formal submission to the court for discontinuing the period of limitation: (i) an application for arbitration; (ii) an application for payment order; (iii) an application for insolvency (submission of claims against the debtor during the insolvency procedure); (iv) an application to declare that the obligor disappeared or died while trying to claim his/her relevant rights; (v) an application for pre-trial assets, protection, or temporary injunction procedure or other similar pre-trial procedures; (vi) an application to enforce the

44 In accordance with article 12 of the Rules on Periods of Limitation, the calculation of the period of limitation should cease running from the day on which the claim is submitted to the court.

45 Including a request made to the counterparty's guarantor, agent, or custodian. Art. 173 of the Opinions on GPCL.

46 This covers when the obligor agrees or acts (i) to repay the debt by instalments, (ii) to repay part of the debt, (iii) to provide guarantee in respect of the debt, (iv) to ask for postponing the repayment date of the debt, or (v) to make a debt repayment plan and so on. Art. 16 of the Rules on Periods of Limitation.

47 Art. 140 GPCL.

48 Art. 173 of the Opinions on GPCL.

49 *Hainan Branch of the China Construction Bank v Hainan Fulin Real Estate Group Co., Ltd. and Hainan Yuhai Industrial Development, Co., Ltd. in respect of a dispute about loan agreement* (中国建设银行海南省分行与海南富林房地产有限公司、海南渝海实业开发总公司借款合同纠纷案), Judgement of Hainan Province Haikou Intermediate Court dated 23th October, 2000.

50 Art. 11 of the Rules on Periods of Limitation.

51 Art. 14 of the Rules on Periods of Limitation.

court judgement; (vii) an application to add an additional party to a trial or one being notified to join a trial; (viii) a set-off claim during the trial.⁵²

25 The calculation of the period of limitation should stop even if the claim is consequently rejected or cancelled by the relevant authority.⁵³ A new period of limitation will start from the day on which the party becomes aware, or should be aware of, the fact that the claim was rejected or cancelled by the relevant authority.⁵⁴ If the claim is not rejected, cancelled or withdrawn, then based on strict literal interpretation of art. 140 GPCL, the period of limitation should re-start to count immediately on the date when the claim is submitted to the court. As a result, if the court procedure lasts for more than 2 years, it is possible that the re-started period of limitation could expire before the court delivers its judgement. In order to cure this theoretical dilemma, leading scholars suggested that in the draft civil code, the period of limitation should not restart to count until the ending date of the court procedure, the effective date of the court judgement, or the deadline for performing obligations as described in the effective court judgement.⁵⁵

c. Request to the Obligor

26 In respect of the meaning of a "request" which interrupts the period of limitation as referred to in art. 140 of the GPCL, the SPC has clarified that it includes the following: (i) when a party directly delivers a document to the counterparty claiming the relevant rights requesting to perform or the counterparty signs or stamps the document. If the counterparty does not sign or stamp the document, there is another method proving the delivery of the document: (ii) when a party claims the relevant rights by mail or electronic data message and the mail or electronic data message reaches or should have reached the counterparty; (iii) regarding a party which is a financial institution, when that party deducts the principal and interest of the outstanding debt from the counterparty's bank account either in accordance with the law or the parties' agreement; (iv) when a party is unable to ascertain the counterparty's whereabouts, that party publishes the relevant right claiming notice in

⁵² Art. 13 of the Rules on Periods of Limitation.

⁵³ Art. 15 of the Rules on Periods of Limitation.

⁵⁴ Ibid.

⁵⁵ HAN Song/JIAO Heping, 74.

national media or influential media in the province of the missing counterparty's domicile, unless the law or judicial interpretation specifies otherwise.⁵⁶

Furthermore, pursuant to art. 174 of the Opinions on the GPCL, a request made to a bank's provincial head branch (which supervises the defendant bank) should be regarded as a request sent to the relevant organisation and would therefore re-start the period of limitation of actions.⁵⁷ However, scholars argue that it seems unreasonable that a mere request to perform will discontinue the period of limitation and suggest that it is more appropriate to include parties' negotiation as a reason to suspend the period of limitation.⁵⁸

d. Joint Debtors

In respect of joint liability debtors, if the period of limitation for claims against one debtor is discontinued and restarted from zero, then the period of limitation for claims against other jointly-liable debtors will also be deemed to have restarted.⁵⁹

e. Transfer of Contractual Rights and Assumption of Obligations

In the case of a transfer of contractual rights or assumption of obligations, the period of limitation regarding the transferred rights or obligations will be discontinued and restarted from zero upon the date on which the notice of the transfer of rights or the expression to be responsible for the original debtor's obligations is delivered to the debtor or the creditor, respectively.⁶⁰ However, there are special rules applicable to the transfer of non-performing debts in China. In accordance with arts. 6 and 10 of the Rules of the SPC on Trials Relating to the Assets of Financial Assets Management Companies Derived from Acquisition, Management, and Disposal of State-Owned Banks' Non-Performing Loans⁶¹, the transferring bank's notification obligation is deemed to be satisfied when the transferring bank has announced the relevant loan transfers in a nationally or provincially influential newspaper. If the

⁵⁶ Art. 10 of the Rules on Periods of Limitation.

⁵⁷ *Huahe International Leasing Co., Ltd v China Construction Bank, Fei County Branch* in respect of a dispute over a guarantee provided for a financial leasing contract (华和国际租赁有限公司与中国建设银行费县支行融资租赁合同担保纠纷案), Judgement of the SPC dated 20th December, 2000.

⁵⁸ *Li Yongfeng*, 66-67.

⁵⁹ Art. 17 of the Rules on Periods of Limitation.

⁶⁰ Art. 19 of the Rules on Periods of Limitation.

⁶¹ (关于审理涉及金融资产管理公司收购、管理、处置国有银行不良贷款形成的资产的案件适用法律若干问题的规定) (法释[2001]12 号) promulgated by the SPC on 11th April, 2001 and effective from 23rd April, 2001.

announcement includes a repayment request, it can be used as evidence to support the interruption of the period of limitation of the transferred debt claim. Therefore, whether or not the borrower is aware of the transfer does not affect the validity of the loan transfer. Furthermore, pursuant to the Reply of the SPC on the Implementation of the SPC's Interpretation No. 12⁶², the relevant financial assets management companies (as transferees of non-performing loans) may also issue the payment request in a nationally or provincially influential newspaper in order to interrupt the applicable period of limitation. These pro-creditor rules are widely regarded as a special tool to deal with the historical, non-performing loans owned by state-owned banks. The SPC has not yet issued further interpretation on the scope of applications of such special rules, but it is doubtful that the special rules should also be applicable to a subsequent transfer of a non-performing loan by a financial assets management company or a normal transfer of bank loans.

4. Extension

- 30** The court may decide to extend the period of limitation of actions under certain circumstances.⁶³ For example, when the claimant fails to bring a claim within the period of limitation as a result of unexpected reasons out of his/her control, the court may extend the period of limitation accordingly.⁶⁴

5. Permissibility of Party Agreement

- 31** In the past, an agreement between parties on the statute of limitations has been impermissible. If parties violate the relevant law to agree to extend or shorten the relevant period of limitation or give up in advance the benefits deriving from the period of limitation, that agreement will not be supported by the court.⁶⁵ This illustrates that the general view in legal practice is to regard the statute of limitations as mandatory and not to be amended by the parties' agreement.⁶⁶ Since GPCL does not have an article expressly prohibiting the parties from agreeing to a period of limitation, it has been suggested that such restrictive provisions should be

⁶² (最高人民法院对《关于贯彻执行最高人民法院“十二条”司法解释有关问题的函》的答复) (法函[2003]3号) promulgated on and effective from 7th January, 2002.

⁶³ Art. 137 GPCL.

⁶⁴ Art. 169 of the Opinions on GPCL.

⁶⁵ Art. 2 of the Rules on Periods of Limitation.

⁶⁶ *Yu Dongai*, 24.

inserted in the draft Chinese civil law.⁶⁷ However, it is worth noting that the focus of the restriction is to amend the length or effect of the statute of limitations before the expiry of the relevant period of limitation.⁶⁸ After the period of limitation expires, the parties are permitted to reach a new agreement regarding the performance of outstanding obligations.⁶⁹

IV. Statute of Limitations in Guarantee Contract

How to calculate the period of limitation for ordinary guarantee claims is still debated **32** among legal practitioners and scholars in China. In general, if the period of limitation for the underlying debt claim is discontinued, the period of limitation for an ordinary guarantee claim will also be discontinued; however, the period of limitation for a joint responsibility guarantee claim⁷⁰ will continue.⁷¹ Furthermore, in accordance with article 34 of Interpretation of the SPC on the Security Law of the People's Republic of China⁷², if the creditor brings a claim against the underlying debtor to a court or arbitration tribunal before the expiry of the guarantee term⁷³, the period of limitation of the ordinary guarantee will start to count from the effective date of the court judgment or arbitration award.

However, after the expiry of the guarantee term, even if the guarantor signs or **33** stamps the payment request of debts due, the guarantor is not deemed to agree to resume the guarantee obligation, unless the form of the signed payment request satisfies the requirements of a new guarantee agreement.⁷⁴

⁶⁷ Ibid.

⁶⁸ Reply of the SPC concerning the Calculation of the Period of Limitation When the Debtor Stamps a Number of Undated Repayment Request Forms after the Debt is Due (关于借款到期后债务人在多份空白催收通知单上加盖公章如何计算诉讼时效的请示的答复), promulgated on and effective from 1st November, 2004.

⁶⁹ Footnote 7 (*supra*).

⁷⁰ Regarding a joint responsibility guarantee, the beneficiary is entitled to bring a claim against the guarantor and the underlying debtor at the same time.

⁷¹ Art. 36 of the Interpretation of the SPC on the Security Law.

⁷² 最高人民法院关于适用《中华人民共和国担保法》若干问题的解释, promulgated on 8th December, 2000 and effective from 13th December, 2000.

⁷³ For an explanation of “guaranty term” c.f. *Chinese Business Law*, 194-195.

⁷⁴ Reply of the Supreme People's Court concerning How To Determine the Signature of a Guarantor on the Letter of Demand after the Term of Guaranty Expires (关于人民法院应当如何认定保证人在保证期间届满后又在催款通知书上签字问题的批复) (法释[2004]4 号), promulgated on 14th April, 2004 and effective from 19th April, 2004.

Relevant Laws & Regulations

Title	Promulgation Date	Effective Date	Last Revision Effective from
Marriage Law (婚姻法)	9/10/1980	1/1/1981	4/28/2001
Constitution (宪法)	12/4/1982	12/4/1982	3/14/2004
Succession Law (继承法)	4/10/1985	10/1/1985	---
General Principles Of Civil Law (民法通则)	4/12/1986	1/1/1987	8/27/2009
Opinions of the Supreme People's Court on Certain Issues concerning the Implementation of the General Principles of Civil Law of the People's Republic of China (Trial) (最高人民法院关于贯彻执行《中华人民共和国民事诉讼法》若干问题的意见(试行))	1/26/1988	1/26/1988	Several articles abolished on 12/24/2008
Regulations for the Registration of Enterprises as Legal Persons (企业法人登记管理条例)	6/3/1988	7/1/1988	1/8/2011
Implementation Rules for Regulations on the Registration of Enterprises as Legal Persons (企业法人登记管理条例施行细则)	11/3/1988	12/1/1988	1/1/2012
Reply of the Supreme People's Court on the Claim Period for Transporting Goods by Water (最高人民法院关于水路货物运输中索赔期问题的复函)	12/8/1988	12/8/1988	---
Civil Procedure Law (民事诉讼法)	4/9/1991	4/9/1991	1/1/2013
Adoption Law (收养法)	12/29/1991	4/1/1992	4/1/1999
Opinions of the Supreme People's Court on Certain Issues Regarding the Implementation of the Civil Procedure Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见)	7/14/1992	7/14/1992	12/24/2008
Maritime Law (海商法)	11/7/1992	7/1/1993	---
Product Quality Law (产品质量法)	2/22/1993	9/1/1993	8/27/2009
Company Law (公司法)	12/29/1993	7/1/1994	1/1/2006
Interpretation of the Supreme People's Court on Certain Issues Concerning the Trial of Cases Involving Compensation for Damage in Rail Transportation (最高人民法院关于审理铁路运输损害赔偿案件若干问题的解释)	10/27/1994	10/27/1994	---
Security Law (担保法)	6/30/1995	10/1/1995	---

Partnership Enterprise Law (合伙企业法)	2/23/1997	8/1/1997	6/1/2007
Reply of the People's Bank of China on Whether Insurance Companies are Entitled to Unilaterally Terminate the Principal-Agent Relationship with Insurance Agents (中国人民银行关于保险公司是否有权单方终止与保险代理人委托代理关系的答复)	4/8/1997	4/8/1997	---
Reply of the Supreme People's Court on Whether a Repayment Agreement Agreed by the Parties after the Expiry of the Period of Limitation of Actions Should be Protected by Law (最高人民法院关于超过诉讼时效期间当事人达成的还款协议是否应当受法律保护问题的批复)	4/16/1997	4/16/1997	---
Regulations on Registration Administration of Associations (社会团体登记管理条例)	10/25/1998	10/25/1998	---
Interim Regulations on Registration Administration of Institutions (事业单位登记管理暂行条例)	10/25/1998	10/25/1998	06/27/2004
Provisional Regulations for the Registration and Administration of Privately-Run Non-Enterprise Institutions (民办非企业单位登记管理暂行条例)	10/25/1998	10/25/1998	---
Reply of the Supreme People's Court on the Legal Consequence of a Signature or Seal Affixed by the Borrower to a Notice Demanding Payment on a Loan after the Expiry of the Period of Limitation of Actions (最高人民法院关于超过诉讼时效期间借款人在催款通知单上签字或者盖章的法律效力问题的批复)	2/11/1999	2/16/1999	---
Contract Law (合同法)	3/15/1999	10/1/1999	---
Interpretation of Supreme People's Court on Certain Issues Regarding the Implementation of the Contract Law of the People's Republic of China (Part I) (最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(一))	12/19/1999	12/29/1999	---
Interpretation of the Supreme People's Court on the Security Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国担保法》若干问题的解释)	12/8/2000	12/13/2000	---
Some Provisions of the Supreme People's Court on Evidence in Civil Procedure (最高人民法院关于民事诉讼证据的若干规定)	12/21/2001	4/1/2002	---
Rules of the Supreme People's Court on Trails Relating to the Assests of Financial Asset Management Companies Derived from Acquisition, Management, and Disposal of State-Owned Banks' Non-Performing Loans (关于审理涉及金融资产管理公	04/11/2001	04/23/2001	---

司收购、管理、处置国有银行不良贷款形成的资产的
案件适用法律若干问题的规定) (法释[2001]12 号)

Reply of the Supreme People's Court on the Implementation of the Supreme People's Court's Interpretation of No. 12 (最高人民法院对《关于贯彻执行最高人民法院“十二条”司法解释有关问题的函》的答复) (法函[2003]3 号)	01/07/2002	01/07/2002	---
Law on the Contracting of Rural Land (农村土地承包法)	8/29/2002	3/1/2003	8/27/2009
Regulations on Foundation Administration (基金会管理条例)	3/8/2004	6/1/2004	---
Reply of the Supreme People's Court concerning How to Determine the Signature of a Guarantor on the Letter of Demand After the Term of Guaranty Expires (关于人民法院应当如何认定保证人在保证期间届满后又在催款通知书上签字问题的批复) (法释[2004]4 号)	04/14/2004	04/19/2004	---
Reply of the Supreme People's Court on Whether Sending a Letter Confirming Outstanding Debts to the Creditor by the Debtor after the Expiry of the Period of Limitation of Actions Constitutes a New Debt (最高人民法院关于超过诉讼时效期间后债务人向债权人发出确认债务的询证函的行为是否构成新的债务的请示的答复)	6/4/2004	6/4/2004	---
Reply of the Supreme People's Court concerning the Calculation of the Period of Limitation When the Debtor Stamps a Number of Undated Repayment Request Forms After the Debt is Due (关于借款到期后债务人在多份空白催收通知单上加盖公章如何计算诉讼时效的请示的答复)	11/01/2004	11/01/2004	---
Real Rights Law (物权法)	3/16/2007	10/1/2007	---
Rules of the Supreme People's Court on Certain Issues Concerning the Implementation of Periods of Limitation in Civil Litigation (最高人民法院关于审理民事案件适用诉讼时效制度若干问题的规定)	8/21/2008	9/1/2008	---
Interpretation of the Supreme People's Court on Certain Issues concerning the Implementation of the Contract Law of the People's Republic of China (Part II) (最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(二))	4/24/2009	5/13/2009	---
Tort Liability Law (侵权责任法)	12/26/2009	7/1/2010	---
Provisions on the Registration Management of Individual Industrial and Commercial Households (个	9/30/2011	11/1/2011	---

Part II Contract

Chapter 4. Overview

Literature: *Cui Jianyuan* (崔建远), *Contract Law (合同法)*, Beijing 2010. *Gu Angran* (顾昂然), *Lecture on the Contract Law of People's Republic of China (中华人民共和国合同法讲话)*, Beijing 1999. *Jiang Ping* (江平), *Preface, Interpretation of Contract Law of People's Republic of China (中华人民共和国合同法精解,前言)*, Beijing 1999. *LIANG Huixing* (梁慧星), *Issues during the Drafting of Contract Law of China (中国合同法起草过程中的争论点)*, *Legal Science (法学)* 1996, No. 2, 13-15. *LIANG Huixing* (梁慧星), *The Uniform Contract Law: Achievement and Deficiency (统一合同法: 成功与不足)*, *China Legal Science (中国法学)* 1999, No. 3, 25-29. *WANG Liming* (王利明), *Exploration on Several Issues on Enacting the Uniform Contract Law, Part One (统一合同法制订中的若干疑难问题探讨 上)*, *Tribune of Political Science and Law (政法论坛)* 1996, No. 4, 49-56. *XIE Huaishi* (谢怀栻), *Conversation by Writing about the New Contract Law – Several Issues on Contract Law.(新合同法笔谈——由《合同法》想到的几点问题)*, *Jurist (法学家)* 1999, No. 3, 69-70. *ZHANG Guangxing* (张广兴), *The Drafting of the Contract Law of People's Republic of China (中华人民共和国合同法的起草)*, *CASS Journal of Law (法学研究)* 1995, No. 5, 3-14.

I. Legislative History of China's Contract Law

As mentioned previously, in the 1980s, China decided to codify its civil law in a progressive way (*supra Chapter 1 at 3*). In 1981, the NPC promulgated the Economic Contract Law (ECL)¹. The ECL only applied to economic contracts between domestic parties due to lack of experience in dealing with foreign economic contracts. On 21st March, 1985, the Foreign Economic Contract Law (FECL)² was enacted. As the name indicates, the FECL was designed to govern contractual relationships between foreign businessmen and Chinese entities. Due to the rapid development of the technology market after 1985, the single two provisions that related to technology contracts in the ECL proved to be insufficient.³ Therefore, the third contract law, the Technology Contract Law (TCL)⁴, came into being in 1987.

Thus, the ECL, the FECL, and the TCL created the “three pillars” of Chinese contract law. However, the separation of contract law into different areas of

¹ 经济合同法, promulgated on 13th December, 1981 and effective from 1st July, 1982; abolished on 1st October, 1999.
² 涉外经济合同法, promulgated on 21st March, 1985 and effective from 1st July, 1985; abolished on 1st October, 1999.
³ *Gu Angran*, 3.
⁴ 技术合同法, promulgated on 23rd June, 1987 and effective from 1st November, 1987; abolished on 1st October, 1999.

domestic economic contracts, foreign economic contracts, and technology contracts led to a fragmented contract law. On the one hand, some provisions in these three laws were duplicative, inconsistent, and even contradictory. On the other hand, some of the most fundamental contract rules, such as the formation of a contract, were still absent. Such a situation failed to meet the requirement of the social and economic life of the time, especially when China announced its adoption of a market-economy system as the goal of its economic reform in 1992. Thereafter, it became necessary for the legislator to provide complete and unified contract rules. In the meantime, on the basis of experience gained from the implementation of the three contract laws as well as the development of legal studies on Chinese contract law, it became possible for China to enact a more sophisticated contract statute.

- 3 In consideration of this necessity and viability, China's legislature decided to adopt a coherent contract law. According to the legislation plan of the Standing Committee of the 8th NPC, the Commission of Legislative Affairs of the SCNPC began to prepare a uniform contract law in October 1993.⁵ Legal scholars and experts from prominent law schools were invited to participate in the legislation work program in order to formulate an advisory draft of the contract law.⁶ This draft would constitute the basis for the final version of the contract law passed.⁷ In 1998, the draft prepared by the Commission of Legislative Affairs was submitted before the SCNPC for the first time. The SCNPC decided to publish the draft in full so that they could solicit opinions from the public. The draft was debated and revised four times by the SCNPC in accordance with these discussed opinions.
- 4 After about six years of drafting, the NPC finally adopted the Contract Law of the PRC (Contract Law, CL)⁸ on 15th March, 1999. The passage of this statute was a significant milestone in the development of China's contract regime. For the first time, there was a single law governing all contractual relations.

II. Major Issues in the Legislation Process

- 5 The process of drafting several versions of the CL caused heated debates. One discussion concerned the question of how to deal with relations between the newly

⁵ Cui Jianyuan, 10.

⁶ LIANG Huixing (1996), 13; ZHANG Guangxing, 4-6; JIANG Ping, 1; XIE Huaishi, 69.

⁷ XIE Huaishi, 69.

⁸ 合同法, promulgated on 15th March, 1999 and effective from 1st October, 1999.

enacted CL and its previous versions, including the General Principle of Civil Law (GPCL).⁹ The final version of the CL aims to replace the three initial contract laws; therefore it was titled the "Uniform" Contract Law of the PRC because it provides unified transaction rules for all contractual relations rather than being affected by the rules of the GPCL. The CL abolishes the differential treatment not only between civil and commercial contracts, but also between domestic economic and foreign economic contracts. The CL governs contracts that do not concern personal relationships, regardless of whether or not they are concluded by a natural person or legal person. The CL also eliminates differences between previous contract laws and sets out coherent rules, including the concept of a contract, the formal requirement of a contract, the performance of a contract, and the liability rule for a breach of contract, etc.¹⁰

Managing the balance between contractual freedom and government intervention **6** was another issue.¹¹ With the purpose of bolstering a market-oriented economy, the CL reaffirms and strengthens the principle of freedom of contract. The CL insists that contract parties enjoy equal legal standing in which neither party may impose its will on the other party.¹² Parties of a contract are entitled to enter into a contract voluntarily under the law.¹³ According to the CL, contracting parties have the right to enter into a contract, to select the contracting party, to determine the content of a contract, and to amend or terminate a contract. The CL removes the provisions about contract administration and contract administration authority and no longer authorizes government agencies to promulgate rules of implementation. The CL also narrows the scope of invalid contracts. In a word, the scope of contractual freedom was greatly expanded.

Thirdly, the question was raised as how to make the rules of the contract law more **7** practical and scientific. Firstly, the CL fills a number of gaps found in previous contract laws. For example, the CL provides systematic rules on the formation of a contract (*infra* Chapter 5 at 2 *et seqq.*), the interpretation of a contract (*infra* Chapter 6 at 9 *et seqq.*), and standard contracts (*infra* Chapter 8). Several new types of

⁹ LIANG Huixing (1996), 14; ZHANG Guangxing, 11-12.

¹⁰ LIANG Huixing (1999), 25-26.

¹¹ LIANG Huixing (1996), 14; ZHANG Guangxing, 12-13; WANG Liming, 50-51.

¹² Art 3 of CL.

¹³ Art 4 of CL.

contracts such as gift contracts, financial leasing contracts, entrustment contracts, and brokerage contracts are included in the CL. Secondly, the CL responds effectively to the demand of real life. For instance, in order to protect the market order and prevent contract fraud or opportunism, the CL gives the obligee the right of subrogation (*infra* Chapter 6 at 45 *et seqq.*) and the right of invalidation (*infra* Chapter 6 at 56 *et seqq.*). Thirdly, the CL adopted a number of legal concepts and doctrines from foreign legal systems or international conventions, including pre-contract liabilities, incidental obligations, rules on the transfer of ownership, and risk of goods, in order to modernise contract law in China.¹⁴

¹⁴ LIANG Huixing (1999), 26.

Chapter 5. Formation and Validity of Contracts

Literature: *Cui Jianyuan* (崔建远), Contract Law (合同法), Beijing 2010. *GUAN Xiaohai* (关晓海), The Offer that the Offeree Has the Reason to Believe It Is Irrevocable and Accept the Offer By Conduct Is Irrevocable (受要约人有理由相信并以行为承诺的要约不可撤销), People's Court Daily (人民法院报), 05/13/2010, 6. *HAN Shiyuan* (韩世远), Pandect of Contract Law (合同法总论), Beijing 2004. *Hu Kangsheng* (胡康生), Interpretation of the Contract Law of People's Republic of China (中华人民共和国合同法释义), Beijing 1999. *JIANG Ping* (江平), A Detailed Explanation of the Contract Law of People's Republic of China (中华人民共和国合同法精解), Beijing 1999. *Li Yongjun* (李永军), Contract Law (合同法), Beijing 2004. *LIANG Huixing* (梁慧星), Pandect of Civil Law (民法总论), Beijing 2007. *MA Qiang* (马强), Study on Seal on Contract (合同盖章问题研究), Journal of Law Application (法律适用) 1999, No. 11, 22-24. *WANG Hong* (王洪), The Absence of Contract Formality and Cure by Performance – Comments on Article 36 of Contract Law (合同形式欠缺以及履行治愈论——兼评合同法 36 条之规定), Modern Law Science (现代法学) 2005, No. 3. *WANG Liming* (王利明), Study on Contract Law Reach Volume I (合同法研究第一卷), Beijing 2002. *Xi Xiaoming* (奚晓明), Several Issues on the Application of Law in Current Civil and Commercial Trial (当前民商事审判工作需要注意的几个法律适用问题), Journal of Law Application (法律适用) 2007, No. 7, 3-7. *ZHANG Xuemei* (张雪梅), On Taking Effect of Contract (论合同生效), Journal of Law Application (法律适用) 2009, No. 9, 19-23.

I. Overview

The Chinese Contract Law (CL) distinguishes between the formation and validity of a contract. Contract formation is understood as a process whereby the contracting parties reach mutual consent. Validity of a contract is part of the state evaluation of a contract that is already formed. Prior to the enactment of the CL, under the Economic Contract Law (ECL), the Foreign Economic Contract Law (FECL) and the Technology Contract Law (TCL), the requirements for formation and validity of a contract were rather rigid and outdated. The CL has substantially adopted international common rules and facilitated freedom of contract by introducing a series of provisions on contract formation, liberating formal requirements and minimizing intervention in business transactions.

1. Formation of Contracts

2 The CL incorporates the offer-acceptance method of contract formation. According to art. 13 CL, a contract is concluded by the exchange of an offer and its acceptance.

a. Offer

(1) Definition

- 3 An “offer” is a party's manifestation of intention to enter into a contract with the other party.¹ The manifestation of intention has two mandatory requirements to meet in order to qualify as an offer. First, its terms are specific and definite. Second, it indicates that upon acceptance by the offeree, the offeror is thereby bound.
- 4 An offer must be distinguished from an “invitation to offer”. An invitation to offer is a party's manifestation of intention to invite the other party to make an offer thereto. A delivered price list, an announcement of auction, a call for tenders, a prospectus, or a commercial advertisement, etc. are deemed invitations to offer. Whether a commercial advertisement constitutes an offer or just an invitation to offer depends on its content. In principle, a commercial advertisement is an invitation to offer rather than an offer. However, if the content of a commercial advertisement meets the requirements of an offer, as set out above, it can be deemed an offer.²
- 5 The CL does not adopt the common law mailbox rule. An offer becomes effective from the point when it reaches the offeree.³ If the party or the offeree designates a specific place or method to receive the offer, such agreements are to be complied with. Otherwise, if the offer arrives at a place under the control of the offeree, such as his domicile or mailbox, then the offer has reached the offeree. However, the offeree needs not know about the existence of the offer beforehand. For example, when a contract is concluded by exchange of electronic messages, if the recipient of an electronic message designates a specific system to receive it and the electronic message enters into said specific system, then the offer takes effect; if no specific

¹ Art. 14 CL.

² Art. 15 CL.

³ Art. 16 CL.

system has been designated, the time when the electronic message first enters into any of the recipient's systems will be deemed the effective time.⁴

(2) Withdrawal and Revocation

The offeror is allowed to withdraw or revoke an offer. Before the offer becomes effective, the offeror can withdraw it, which means that the notice of withdrawal must reach the offeree before or at the same time as the offer.⁵ After the offer becomes effective, the offeror can also revoke the offer, provided that the notice of revocation reaches the offeree before he has dispatched a notice of acceptance.⁶ To protect the offeree, an offer may not be revoked in two cases: (i) when it expressly indicates, either by stating a fixed time for acceptance or otherwise, that it is irrevocable; or (ii) when the offeree has reason to believe that the offer is irrevocable and has already undertaken preparations for performance.⁷ In the case *Yellow River Engineering Consulting Co., Ltd. v Henan Zongheng Gas Pipeline Co., Ltd.*,⁸ the Gas Pipeline Company was negotiating a technology consulting contract with the Engineering Consulting Company. During the negotiation, the Gas Pipeline Company sent a letter to the Engineering Consulting Company, which stated that in order to complete the technology consulting program as soon as possible, the Engineering Consulting Company should start to work after the arrival of said letter. Thus, the Engineering Consulting Company began some of the investigation and design work. Later, the Gas Pipeline Company notified the Engineering Consulting Company to stop the program. The court ruled that the first letter was an irrevocable offer according to art. 19 para. 2 CL.⁹

b. Acceptance

(1) Definition

An “acceptance” is the offeree's manifestation of intention to assent to an offer. Silence or inactivity does not by itself amount to an acceptance. However,

⁴ Art. 16 CL.

⁵ Art. 17 CL.

⁶ Art. 18 CL.

⁷ Art. 19 CL.

⁸ *Yellow River Engineering Consulting Co., Ltd. v Henan Zongheng Gas Pipeline Co., Ltd.* (黄河勘测规划设计有限公司诉河南纵横燃气管道有限公司技术咨询合同纠纷案), judgement of the High People's Court of Henan Province dated 15th December, 2009.

⁹ *GUAN Xiaohai*, 6.

acceptance can be inferred from the conduct of the offeree under the condition that this mode of acceptance is permitted according to the relevant usage or indicated in the offer.¹⁰ Similar to an offer, an acceptance becomes effective from the point when it reaches the offeror. An acceptance can also be withdrawn, provided that the notice of withdrawal reaches the offeror before or at the same time as the acceptance arrives.¹¹

(2) Period for Acceptance

- 8** An acceptance must reach the offeror within the period for acceptance, which is either specified in the offer or to be determined according to art. 23 para. 2 CL: (i) when the offer is made orally, the acceptance is to be dispatched immediately, unless otherwise agreed upon by the parties; (ii) when the offer is made in a non-oral manner, the acceptance must reach the offeror within a reasonable time.
- 9** Art. 24 CL stipulates that, where an offer is made via letter or telegram, the period for acceptance commences on the date shown on the letter or the date on which the telegram is turned in for dispatch. If the letter does not specify a date, the period will commence on the posting date stamped on the envelope. When the offer is made through an instantaneous communication device such as a telephone or facsimile, etc., the period for acceptance commences once the offer reaches the offeree.
- 10** An acceptance received by the offeror after expiration of the period for acceptance constitutes as a new offer, unless the offeror timely advises the offeree that the acceptance is valid.¹² If the offeree dispatches his acceptance within the period for acceptance, and the acceptance, which would otherwise have reached the offeror in due time under normal circumstances, reaches the offeror after expiration of the period for acceptance due to any other reason, the acceptance will be held valid, unless the offeror timely advises the offeree that the acceptance has been rejected on grounds of its delay.¹³

(3) Battle of Forms

¹⁰ Art. 22 CL.

¹¹ Art. 27 CL.

¹² Art. 28 CL.

¹³ Art. 29 CL.

A contract is concluded by the offer and acceptance process. Once the acceptance becomes effective, a contract is formed. In practice, parties may have disputes over whether the offer and the acceptance processes have finished. Art. 30 CL stipulates that the terms of the acceptance must be identical to those of the offer, which creates the impression that the CL adopts the mirror rule. This is however not true. In fact, the CL distinguishes between material and non-material alterations to an offer.

A purported acceptance dispatched by the offeree that materially alters the terms of the offer constitutes a new offer. Art. 30 CL explains that changes concerning the subject matter, quantity, quality, price or remuneration, time, place and method of performance, liabilities for breach of contract, or the method of dispute resolution are considered material changes to the terms of the offer. An acceptance containing non-material changes to the terms of the offer is nevertheless valid and the terms thereof prevail as the terms of the contract, unless the offeror timely objects to such changes or the offer indicates that the acceptance may not contain any changes to its terms. **12**

Some scholars argue that it is not an absolute rule to deem changes concerning subject matter, quantity, quality, price, or remuneration as material changes and that minor changes to these items may be acceptable sometimes.¹⁴ Since the items which are regarded as material clauses actually cover most of the content of a contract, almost any change to the conditions set out in the offer can be regarded as change to subject matter, quantity, quality, price, or remuneration, etc. Thus, minor changes to these so-called material items such as adding an illustrative clause about an item, inserting clauses which have been stipulated by law, or adding minor adjustments, are permitted and treated as non-material changes. **13**

Generally speaking, it is clear that the Chinese legislator has been influenced by the approach of art. 19 United Nations Convention on Contracts for the International Sale of Goods (CISG) and art. 2.22 Principles of International Commercial Contracts (PICC). Although a mirror image is generally required for the formation of a contract, the CL permits the offeree to make minor alternations to the offer. Nevertheless, contracting parties usually do not discuss all the clauses of a contract in detail. If the parties reach a consensus on the names of the parties, subject matter, and quantity **14**

¹⁴ WANG Liming, 235.

but leave other content of the contract intentionally or unintentionally blank, in general the court will be bound to rule that the contract has been concluded, unless otherwise provided by law or agreed upon by the relevant parties.¹⁵ When the parties cannot reach an agreement on other terms beyond the subject matter and quantity of the contract, the court can determine these issues in accordance with the gap-filling and interpretation provisions, including arts. 61, 62, and, 125, of the CL.

c. Letter of Intent

- 15** During the conclusion of a contract, parties may first execute some kind of documents such as a letter of subscription, a letter of intent, or a memorandum of understanding before they enter into a formal contract. If the document contains the provision that the parties are obligated to conclude a formal contract in a certain period of time, such a document will constitute a pre-contract. When one party refuses to conclude a formal contract, the other party is entitled to request him/her to bear the liability for breaking the pre-contract or to rescind the pre-contract.¹⁶

2. Validity of Contracts

a. Valid Contracts

- 16** A contract that is formed in accordance with the law becomes valid or effective immediately upon its formation.¹⁷ A contract will generally be valid if (i) it is made by the parties who possess corresponding legal capacity (*supra* Chapter 2 at 1 *et seqq.*), (ii) it is the true intention of the parties, and (iii) it does not contravene any law or public interests.

b. Void Contracts

- 17** According to art. 52 CL, a contract is void under any of the following circumstances:
(i) one party induced a conclusion of the contract through fraud or duress, thereby

¹⁵ Art. 1 of the Interpretation of the SPC of Certain Issues concerning the Application of the CL (Part II) (最高人民法院关于适用中华人民共和国合同法若干问题的解释(二)), promulgated on 24th April, 2009 and effective from 13th May, 2009 (hereinafter: Interpretation of the CL (Part II)). Certainly, if the parties are clearly aware that acceptance does not match the offer of material clauses, such as the subject matter, quantity, quality, price, or remuneration, then there is no agreement between them.

¹⁶ Art. 2 of the Interpretation of the SPC of Issues concerning the Application of Law in Trials of Disputes over Purchase and Sales Contracts (最高人民法院关于审理买卖合同纠纷案件适用法律问题的解释), promulgated on 10th May, 2012 and effective from 1st July, 2012 (hereinafter: Interpretation of Trials of Purchase and Sales Contracts).

¹⁷ Art. 44 CL.

harming the interests of the state; (ii) the parties colluded in bad faith, thereby harming the interests of the state, the collective or any third party; (iii) the parties intended to conceal an illegal purpose under the guise of a legitimate transaction; (iv) the contract harms public interest; (v) the contract violates a mandatory provision of any law or administrative regulation.

Under art. 54 CL, contracts formed by fraud or duress are generally voidable (*infra* 18 at 27). However, in actual life, the contracting party who functions on behalf of the state's interest sometimes does not exercise the right to declare the contract void when he/she is deceived or intimidated. In order to protect the interests of the state, especially state-owned property, the CL nullifies such contracts.¹⁸ This rule may be helpful in protecting national interest. However, the CL does not make a clear definition of the interests of the state, which leads to uncertainty in the application of this rule. Some scholars regard the interests of the state as national political interest, national security, or national economic interest and exclude the interest of state-owned enterprises,¹⁹ while other scholars deem the state's interests as public interest.²⁰ Limiting the scope of national interest is necessary for reducing the uncertainty of this rule, but equating the interests of the state, as provided in art. 52 (1) CL, with public interest may not be the proper interpretation since art. 52 (4) CL explicitly handles the situation of a contract harming public interest.

Malicious collusion means contracting parties intentionally enter into a contract 19 which results in injury to the interests of the state, the interests of the collective or any interests of a third party. For instance, the vendor of a property may collaborate maliciously with someone by executing a sales contract with him/her, and then delivering the property to this person rather than to the first buyer. As a result, the first buyer of the property cannot obtain the property.²¹ As malicious collusion involves the mental state of the contracting parties, the court will make a judgment through a comprehensive overview of the relevant circumstances, such as the

¹⁸ Hu Kangsheng, 89-90.

¹⁹ WANG Liming, 643.

²⁰ LIANG Huixing, 179.

²¹ Art. 10 of the Interpretation of the SPC Issues concerning the Application of Law in Trials of Disputes over Purchase and Sales Contracts of Commodity Premises (最高人民法院关于审理商品房买卖合同纠纷案件适用法律若干问题的解释), promulgated on 28th April, 2003 and effective from 1st June, 2003 (hereinafter: Interpretation of Commodity Premises).

situation under which the contract was concluded, the content of the contract, and the performance of the contract.²²

- 20** Art. 52 (4) CL is derived from art. 58 (5) GPCL.²³ “Public interest” in this paragraph means public order and morality (*boni mores*).²⁴ According to commentators, contracts that violate public order or social morality, such as harming family relationships, violating sexual ethics, interfering with one’s personality, infringing on workers’ interests or consumers’ interests, limiting economic liberty, or hindering competition will be determined to harm public interest.²⁵ Since art. 52 (5) CL explicitly stipulates that a contract which violates mandatory provision is void, if said contract violates public order or social morality has been clearly determined to be illegal by a mandatory provision, then such a contract will be declared void according to art. 52 (5) CL rather than art. 52 (4) CL.²⁶
- 21** An illegal contract is void. A contract with an illegal purpose under the guise of a legitimate transaction is also illegal. This rule seems simple and clear. Yet, the reality is that there is a great number of mandatory provisions in the laws and administrative regulations in China. If a contract that violates any mandatory provisions were regarded void, then the number of invalid contracts would be too large. That would threaten the stability of commercial transactions, which contradicts one fundamental principle of the CL concerning the facilitation and preservation of contracts. In accordance with this principle, the court is bound to take a cautious attitude towards nullifying a contract and to abide by the following rules established by the SPC:
- 22** Firstly, “laws and administrative regulations” simply refers to laws adopted by the NPC and/or its Standing Committee and administrative regulations adopted by the State Council. No provincial, municipal, or other local rules or regulations qualify as sources of mandatory rules in the sense of art. 52 (5) CL.²⁷ If a violation of local regulations or administrative rules leads to damage of public interest, the court is

²² *Chen Quan and Pi Zhiyong v Chongqing Bibo Real Estate Development Co., Ltd., Xia Changjun and Chongqing Aokang Properties Co., Ltd.* (陈全、皮治勇诉重庆碧波房地产开发有限公司、夏昌均、重庆奥康置业有限公司合同纠纷案), judgement of SPC dated 31st May, 2001.

²³ Art. 58 para. 5 GPCL provides that civil acts that violate either the law or public interests shall be considered void.

²⁴ *HU Kangsheng*, 90; *LIANG Huixing*, 205; *WANG Liming*, 652.

²⁵ *LIANG Huixing*, 207-209; *CUI Jianyuan*, 104.

²⁶ *CUI Jianyuan*, 104; *WANG Liming*, 654; *Li Yongjun*, 378, 382-383.

²⁷ Art. 4 of the Interpretation of the CL (Part I).

then allowed to nullify the contract on the ground that the contract harms public interest rather than violating local regulations.²⁸

Secondly, the term "mandatory provisions" stipulated in art. 52 (5) CL only refers to **23** mandatory provisions on validity.²⁹ The purpose of mandatory provisions is different. The legislator does not usually deliberately take into consideration the impact of every mandatory provision on the validity of a contract. Some mandatory provisions aim to safeguard public order rather than to intervene in private transactions. These mandatory provisions usually serve to regulate the behavior of the regulated party rather than the unregulated party. The regulated party in violation of mandatory provisions deserves punishment, but the other party is innocent, so the relevant contract should not be nullified. These types of mandatory provisions are called mandatory provisions of management. On the contrary, some mandatory provisions articulate or imply that a violation will lead to the voidness of a contract. These types of mandatory provisions are called mandatory provisions of validity. Only when a mandatory provision aims at regulating the validity of a contract, that is to say, when confirming the validity of a contract will impede the achievement of the purpose of the mandatory provision, the court can nullify the contract.³⁰

For example, art. 39 of the Law on Commercial Banks stipulates that the loan **24** business of a commercial bank should abide by regulations of the assets ratio and liabilities provided by the law. This article is classified as a provision of management by the standards set by the SPC. A commercial bank may enter into a contract and as a result violates the mandatory assets ratio and liabilities. This leads to the imposition of administrative punishment of the commercial bank, but will not affect the validity of the contract.³¹ Similarly, art. 44 of the Law on Administration of Urban Real Estates provides that in commercial housing pre-sales, the sales contract must be filed or registered with the relevant administrative agency. The filing or registration of the sales contract is an administrative management measure taken by

²⁸ Xi Xiaoming, 3.

²⁹ Art. 14 of the Interpretation of the CL (Part II).

³⁰ Art. 16 of the Opinions of the SPC on Issues concerning Trials of Disputes over Civil and Commercial Contracts under the Current Situation (最高人民法院关于当前形势下审理民商事合同纠纷案件若干问题的指导意见), promulgated on and effective from 7th July, 2009 (hereinafter: Opinions on Trials under the Current Situation).

³¹ Reply of the SPC on the Effectiveness of Lending Contracts Concluded by a Credit Union in Violation of Relevant Provision of the Commercial Bank Law (最高人民法院关于信用社违反商业银行法有关规定所签借款合同是否有效的批复), promulgated on and effective from 29th January, 2000.

the government agency rather than a necessary precondition for confirming the validity of the contract. Parties of the commercial housing sale are barred from asserting that the contract is void due to a lack of filing or registration.³²

- 25** In a deposit dispute case, a credit union alleged that the contract is void because the interest provided in the contract exceeds the interest limit set by the Central Bank. According to the Regulations of the Administration of Savings³³, the credit union is not allowed to violate the interest limitation. The court ruled that the limitation aims to regulate the behavior of financial institutions; thus, the validity of the contract is unaffected.³⁴ In an interbank lending dispute case, the court pointed out that although the Law on Commercial Banks stipulates that interbank lending should observe the central bank's relevant regulations, the provision does not aim to affect the validity of the interbank lending contract. The regulator punishes financial institutions violating financial regulations, but they cannot deny the contract on this ground.³⁵

c. Contracts with Pending Validity

- 26** Contracts concluded by persons with limited civil capacity for civil act (*supra* Chapter 2 at 9) and contracts concluded by unauthorised agents (*supra* Chapter 2 at *et seqq.*) have only pending validity.³⁶ Such a contract becomes valid upon ratification by the legal representative or the principle. In both cases, the other party is entitled to demand the legal representative or principle to ratify the contract within one month. Failing to timely ratify the contract is deemed a declination of ratification. Prior to the ratification of the contract, the other party in good faith is entitled to rescind the contract. The principal's commencement of performance of the contract is deemed ratification of the contract. Good faith of the other party in the possession of agency authority is legally protected under certain circumstances (*supra* Chapter 2 at 37).

³² Art. 6 of the Interpretation of Commodity Premises.

³³ 储蓄管理条例, promulgated by the State Council on 11th December, 1992 and effective from 1st March, 1993.

³⁴ *Jiangnan Branch of the Rural Credit Cooperatives Union of Meijiang District, Meizhou City v Luo Yuanling* (梅州市梅江区农村信用合作联社江南信用社诉罗苑玲储蓄合同纠纷案), judgement of the Meizhou Intermediate People's Court dated 15th December, 2009.

³⁵ *Xi'an Commercial Bank v Capital-Bridge Securities Joint Stock Co., Ltd, West Credit Guaranty Co., Ltd* (西安市商业银行与健桥证券股份有限公司、西部信用担保有限公司借款担保合同纠纷案), judgement of the SPC dated 27th September, 2005.

³⁶ Arts. 37 and 47 CL.

d. Voidable Contracts

If there is a flaw in the genuineness of a party's manifestation of intention, the **27** contract may be adapted or rescinded. Art. 53 CL sets out that material mistakes, fraud, and duress constitute grounds to invalidate a contract. Material mistakes refer to fundamental misconceptions such as mistakes with respect to the nature of the transaction, the counterparty, or the amount, size, quality of subject matter etc. Under these circumstances, the disadvantaged party is entitled to amend or rescind the contract.

When a contract is grossly unconscionable or when one party takes advantage of **28** the other party's hardship, the aggrieved party has the right to petition the court or an arbitration tribunal to amend or rescind the contract. When a party petitions for amendment of the contract, the court or arbitral institution may not instead rescind the contract. However, there are some limitations to a party's right to amend or rescind a contract. Firstly, this right will extinguish if the party fails to exercise the rescission right within one year, commencing on the date when the party knew or should have known the cause for rescission. Secondly, this right may also be waived by the right-holder through either an express statement or conduct upon learning the grounds for his/her exercising this right.³⁷ It is notable that the exertion of the right to amend or rescind a contract may be done only by way of petition to the court or arbitration tribunal. The aggrieved party itself cannot amend or rescind the contract.

II. Main issues

1. Contract Signature

According to art. 32 CL, if parties enter into a contract by a memorandum of a **29** contract, the contract will be formed when it is signed or sealed by the parties. In China, a contract concluded by a company or institution will generally be sealed under the company's or the institution's official seal. In practice, there is a great number of contract disputes relating to the seal.

³⁷ Art. 55 CL.

a. Contracts without a Seal

30 It can be inferred from art. 32 CL that affixing a seal is not a precondition for the formation of a contract when a contract is not concluded in the form of a memorandum of contract. Signatures and seals have the same effect. Where a contract is to be concluded by a memorandum of contract, if one party does not sign or seal the contract, then the contract is not formed. On this occasion, as the contract is not formed, the party who signed or sealed the contract can only claim compensation on grounds of pre-contractual liability. However, if one party has performed its main obligation prior to signing or sealing the contract, and the other party has accepted the performance, then the contract will be formed.³⁸

b. Seal by a Branch of a Corporation

31 A branch of a corporation may conclude a contract in its own name because it is regarded as a type of “other organization” as provided in art. 2 CL. A branch usually has its own official seal. When a branch seals the contract with its own official seal, the contract is duly formed.

32 It should be noted that a branch of a corporation is different from a functional department of a corporation. A functional department, such as the department of economics of a college or the human resources department of a corporation is deemed an integral part of a legal person and is unable to conduct civil acts in its own name. If a functional department seals the contract the contracting party will be the corporation rather than the department, since the department is not an independent civil subject.³⁹

c. Seal with the Permission of the Seal's Owner

33 One person may enter into a contract in the name of a corporation or other organization after obtaining the permission of the corporation or other organization to use the corporation's or other organization's business letter of introduction (介绍信; an equivalent of certificate of employment or affiliation) or memorandum of contract. The business letter of introduction or memorandum of contract is usually stamped with the corporation's or other organization's official seal. In this case, the

³⁸ Art. 37 CL.

³⁹ *MA Qiang*, 24.

corporation or other organization which allows another person to use its name is liable for the contract concluded by the person. The counterparty of the contract can ask the corporation or other organization for performance except in the case that he/she is fully aware of the fact that the party negotiating with him merely borrows the seal of the other.⁴⁰

d. Seal without the Permission of the Seal's Owner

When the staff of a corporation or other organization uses the corporation's or other organization's business letter of introduction or memorandum of contract under the official seal without its respective authorisation, then the corporation or other organization is nevertheless liable for the contract. The fact that the staff can use the official seal without authorisation illustrates that the behavior of the staff is inadequately monitored and constitutes agency by estoppels (*supra* Chapter 2 at 33). Therefore, the corporation or other organization cannot defend itself with the argument of having no relationship with the contract. **34**

A seal by staff without authorisation is different from a seal in secret. Where the official seal is stamped in secret, the owner of the seal is not liable for the contract.⁴¹ This is the case because the owner can never absolutely prevent an outsider from stealing his/her seal. **35**

e. Forged Seal

Where one person engraves a corporation's or other organization's seal in secret and seals the contract with the forged seal, then the corporation or other organization is usually not liable for the contract. However, if the corporation or other organization is apparently at fault and there is a causal relationship between fault and the loss of the aggrieved party, then the corporation or other organization is liable.⁴² In the case of *Guangzhou Branch of the Industrial Bank v Shenzhen Airport Co., Ltd.*⁴³, the CEO of the airport corporation concluded the contract with a seal engraved in secret rather than with an official seal of the corporation. The SPC ruled **36**

⁴⁰ Art. 4 of the Rules of the SPC on Issues in Trials of Economic Disputes involving Economic Crime (最高人民法院关于在审理经济纠纷案件中涉及经济犯罪嫌疑若干问题的规定), promulgated on 21st April, 1998 and effective from 21st April, 1998 (hereinafter: Rules in Trials involving Economic Crime).

⁴¹ Art. 5 of Rules in Trials involving Economic Crime.

⁴² Art. 5 of Rules in Trials involving Economic Crime.

⁴³ *Guangzhou Branch of the Industrial Bank v Shenzhen Airport Co., Ltd.* (兴业银行广州分行与深圳市机场股份有限公司借款合同纠纷案), judgement of the SPC dated 4th January, 2009.

that although the contract was under a seal engraved by the third party, the airport corporation had done too little to monitor its own senior management, and thus it is liable for the bank's loss.⁴⁴

2. Form of Contract

a. Form Requirement

- 37** According to art. 10 CL, a contract may take written form, oral form, or any other form. Written form may either be required by law or agreed upon by the parties. Such a statutory form requirement exists with regard to a loan agreement (art. 197 CL), a lease agreement for a term longer than six months (art. 215 CL), a financial leasing contract (art. 238 CL), and a contract for a construction project (art. 270 CL). Art. 11 CL defines "written form" as any form in writing, such as documents, letters and electronic data text (including a telegram, telex, fax, electronic data exchange and email), that can tangibly express the contents contained in it. Fingerprints can replace signatures or seals.⁴⁵
- 38** A flaw in meeting form requirement will be deemed cured, if one party has performed its main obligation and the other party has accepted the performance.⁴⁶ In addition, the CL also provides other forms of relief. For example, art. 215 CL provides that, if the parties fail to make the lease contract in written form, the lease will be deemed an open-end lease, i.e. a lease without a fixed term. The central point of the rule relating to the form of a contract is that contracting parties have the freedom to decide on the form of contracts. To prevent opportunism, performance may serve to rectify a defect in the form of a contract.⁴⁷

b. Government Approval or Registration

- 39** Art. 44 CL provides that if the validity of a contract is subject to any procedure such as approval or registration, etc., as required by the relevant law or administrative regulation, the contract takes effect after the relevant requirements are satisfied. In practice, the application of this provision is hampered by the fact that many laws and

⁴⁴ *Guangzhou Branch of the Industrial Bank v Shenzhen Airport Co., Ltd.* (兴业银行广州分行与深圳市机场股份有限公司借款合同纠纷案), judgement of the SPC dated 4th January, 2009.

⁴⁵ Art. 5 of the Interpretation of the CL (Part II).

⁴⁶ Arts. 36 and 37 CL.

⁴⁷ *WANG Hong*, 84-85.

regulations only introduce the requirements of approval or registration without specifying whether such an approval or registration constitutes a precondition for the validity of the contract. To solve this problem, it is useful to divide the approval requirements into three categories:⁴⁸

The first category is a qualification requirement for market access. For example, **40** conducting a commercial bank business requires permission from the banking regulator. A contract concluded exceeding the business scope of either party is not *per se* void. However, when the party goes beyond the business scope and engages in business that is prohibited or subject to an authority's permission according to law or any administrative regulations, the contract is void.

The second category aims at controlling transactions. For example, the transfer of **41** state-owned assets by state-owned enterprises is subject to approval by the relevant government agency. As these approval requirements are designed to control transactions, they doubtlessly constitute a precondition for the validity of the contract.

The third category regulates the performance of a contract rather than a contract **42** itself. Under this circumstance, the approval requirement will not affect the effectiveness of the contract. The fulfilment of a real estate purchase agreement is a typical example in this regard (*infra* Chapter 14 at 18 *et seqq.*)

As to registration requirements, it is usually not considered a precondition for the **43** validity of the contract unless otherwise stipulated by law. A registration requirement is often designed to inform the government agency of the existence of a civil act between the contracting parties rather than to empower the agency to approve the civil act. Although the Guarantee Law contains some provisions which stipulate that registration is a precondition for the validity of a mortgage contract and a pledge contract, the Real Rights Law (RRL)⁴⁹ has amended these provisions.⁵⁰

In conclusion, whether the procedure requirement is a precondition for the validity of **44** a contract is determined by several elements. The court is bound to make a

⁴⁸ ZHANG Xuemei, 19-23.

⁴⁹ 物权法, promulgated on 16th March, 2007 and effective from 1st October, 2007.

⁵⁰ Arts. 41 and 78 of the Security Law (担保法), promulgated on 30th June, 1995 and effective from 1st October, 1995; Arts. 15, 24, and 188 RRL.

balanced judgment by taking into account the text, the purpose, and the historic background of the relevant provision.

- 45** Where approval or registration is a prerequisite for the effectiveness of a contract, the party responsible for securing such approval or registration is obligated to apply for the approval or registration, albeit the contract has not entered into effect lacking the relevant approval or registration. A failure to discharge this duty is deemed a violation of the principle of good faith. The court may, according to the specific conditions of the case and upon the request of the persons concerned, permit the other party to apply for the relevant governmental approval at the breaching party's cost. The breaching party is responsible for compensating the actual losses of the other party.⁵¹ In a dispute before the court, the breaching party is allowed to secure the approval or registration by the end of the court hearing within the first instance trial.

3. Advertisements of Rewards

- 46** Advertisements of rewards for the return of lost or stolen property are commonly regarded as offers under common law, while it is a controversial issue in the civil law system. In China, advertisements of rewards are generally regarded as a unilateral juristic act rather than a contract. That is because advertisements of rewards are established by the expression of intent of a single party, without the assent of the other party, or without the existence of a counterpart. A contract is typically a bilateral act, which can only be established with the consent of two parties.
- 47** Art. 112 RRL confirms the validity of advertisements of rewards. The right holder of the object, when obtaining a lost-and-found object, is bound to pay the person who finds the object or the authority who takes over the object from the finder the necessary expenses such as the costs for safekeeping the object. Where a right holder promises to offer a reward for finding the object, he is bound to perform the obligation of granting the reward when claiming the object.
- 48** According to the Interpretation on the CL (Part II), in cases where the reward offeror makes a public announcement to pay the person who accomplishes a certain activity and the said person requests such payment upon the completion of such

⁵¹ Art. 8 of the Interpretation of the CL (Part II).

activity, then the court is bound to uphold the request, unless the reward has one of the circumstances prescribed in art. 52 CL. The purpose of the interpretation is merely to clarify that the person can request such payment upon the completion of the requested activity. Whether advertisements of rewards are a contract or a unilateral juristic act is left to academic discussion.

4. Pre-contractual Liability

In accordance with the principle of good faith, the CL imposes certain liabilities even before a contract is formed or becomes effective. This so-called pre-contractual liability is applicable to the following conducts: (i) negotiating in bad faith under the pretext of concluding a contract, (ii) intentionally concealing a material fact relating to the conclusion of the contract or supplying false information, (iii) any other conduct which violates the principle of good faith.⁵² 49

Pre-contractual duties include, *inter alia*, the duty to protect the other party, the duty to maintain secrecy, and the duty of cooperation. Bad faith may be reflected in malicious negotiation, misrepresentation, delay in fulfilling the obligations necessary for the contract to go into effect, and infringing on the other party's legitimate interest. The behavior of bad faith cannot be exhaustively enumerated. "Negotiating in bad faith" is a typical example of bad faith behavior during the formation of a contract. Negotiating in bad faith is to be interpreted in a broad sense. Not only entering into negotiation in bad faith, but also continuing the negotiation in bad faith or breaking off the negotiation in bad faith are considered cases of negotiating in bad faith.⁵³ 50

Under the same principle, a party is prohibited from disclosing or improperly using any trade secret of which the party became aware in the course of negotiating a contract, regardless of whether a contract has been formed.⁵⁴ 51

In addition, the duty to apply for the relevant approval or registration (*supra* at 39-45), is also classified as a pre-contractual duty by art. 8 of the Interpretation of the CL (Part II). 52

⁵² Art. 42 CL.

⁵³ *HAN Shiyuan*, 141.

⁵⁴ Art. 43 CL.

Chapter 6. Performance, Termination and Cancellation

Literature: CAO Shouye (曹守晔), Comprehension and Application of Change in Circumstances in the Interpretation of the Supreme People's Court of Certain Issues Concerning the Application of the Contract Law of the People's Republic of China (Part II) (最高人民法院《关于适用〈中华人民共和国合同法〉若干问题的解释(二)》之情势变更问题的理解与适用), *Journal of Law Application (法律适用)* 2009, No. 8, 44-49. Cui Jianyuan (崔建远), *Contract Law (合同法)*, Beijing 2010. Cui Jianyuan (崔建远)/Wu Guangrong (吴光荣), Rules of Exercising the Right of Rescission in Chinese Contract Law (我国合同法上解除权的行使规则), *Journal of Law Application (法律适用)* 2009, No. 11, 14-18. DUAN Kuang (段匡), Application of Obligor's Right of Subrogation in Japan (日本债权人代位权的运用), *Civil and Commercial Law View Vol.16 (民商法论丛第十六卷)* 2000, 524-545. GU Angran, (顾昂然), *Lectures on the Contract Law of the People's Republic of China (中华人民共和国合同法讲话)*, Beijing 1999. HAN Shiyuan (韩世远), *Pandect of Contract Law (合同法总论)*, Beijing 2004. LI Guohui (李国慧), An Interview with Song Xiaoming, the Presiding Judge of the No. 2 Civil Division of the Supreme People's Court on Issues concerning Contract Law Practice (就合同法司法实务相关问题访最高人民法院民二庭庭长宋晓明), *Journal of Law Application (法律适用)* 2009, No. 11, 10-13. LIU Lan (刘岚), Interpretation of the Supreme People's Court of Certain Issues Concerning the Application of the Contract Law (Part II) by the Head of the Research Office of the Supreme People's Court (最高人民法院研究室负责人详解合同法解释(二)), *People's Court Daily (人民法院报)*, 06/08/2009, 4. LIU Ziping (刘子平)/Wu Xingzheng (吴行政), Analysis of Several Rules on the Right of Subrogation (代位权诉讼若干制度析解), *China Civil and Commercial Trial (中国民商审判)* 2004, No. 1, 19-34. SHI Jianhui (施建辉), Limit on Defense of Simultaneous Performance (同时履行抗辩之适用限制), *Journal of the East China University of Political Science and Law (华东政法大学学报)* 2007, No. 4, 44-50. WANG Chuang (王闯), On Right of Defense of Simultaneous Performance of Bilateral Contract, Explanation of Issues on the Application of Art. 66 of the Contract Law (论双务合同履行中的同时履行抗辩权——兼释合同法第六十六条及其适用中的相关疑难问题), *Legal Forum (法学论坛)* 2007, No. 3, 15-18. WANG Chuang (王闯), Issues on the Application of Law in Hearings concerning Commercial Contract Disputes by the People's Courts (当前人民法院审理商事合同案件适用法律若干问题), *Journal of Law Application (法律适用)* 2009, No. 9, 3-8. WANG Liming (王利明), On the Essential Conditions for Exercising the Right of Subrogation (论代位权的行使要件), *Legal Forum (法学论坛)* 2001, No. 1, 36-45. WANG Liming (王利明), *Study on Contract Law Vol. II (合同法研究(第二卷))*, Beijing 2002. WANG Liming (王利明), *Study on New Issues of Contract Law (合同法新问题研究)*, Beijing 2003. XUE Wencheng (薛文成), Right of Rescission of a Contract and its Exercise (论合同解除权以及合同解除权的行使), *Oriental Law (东方法学)* 2008, No. 1, 152-160. ZENG Xiangsheng (曾祥生), Exercising the Right of Rescission of a Contract (论合同解除权之行使), *Law Review (法学评论)* 2010, No. 2, 147-152. ZHENG Yunrui (郑云瑞), *Studies on Certain Issues of the General Principles of Contract Law*, *Singapore Journal of International and Comparative*

Law. 2003, No. 7, 28-58. *ZHONG Kewei* (钟可慰), Right of Subrogation in Disputes between Huaxia Bank Suzhou Branch v Shanghai Huxiang Industry and Trade Co., Ltd., Yuzhong, Suzhou Economics and Trade Co., Ltd., Jiangsu Province Supply and Marketing Cooperative (Group) (华夏银行苏州支行诉上海沪湘工贸有限公司、余忠、江苏省供销社(集团)苏州经贸有限公司代位权纠纷), *Chinese Civil and Commercial Trials* (中国民商审判) 2003, No. 3, 42-53.

Chinese contract law follows the *pacta sunt servanda* principle, which is one of the 1 basic principles of contract law. This principle requires contracting parties to fulfill respective obligations in accordance with a valid contract. As a general rule, one party is not allowed to modify the contract without the consent of the other party, and the contract is terminated only when the performance has been tendered. There may, however, be cases of special or exceptional circumstances that occur during the performance of a contract, such as the purpose of the contract can no longer be achieved, or substantial changes have happened, etc. Accordingly, contract law provides rules to address these situations.

Chinese contract law also recognizes the doctrine of privity of contract. In principle, 2 the contracting party can only claim contractual rights against the other party and owes obligation to the other party. As an exception, contract law admits in very limited situations that a contract may have an effect on a third party. The right of subrogation and the right of invalidation are the main instances of this issue.

I. Performance of Contract

The main purpose for a party to enter into a contract is to obtain the performance of 3 the other party. Thus, a basic rule in contract law is that parties must fully perform their respective obligations in accordance with the contract. However, contractual commitments are not limited to the explicit content, but also include the principle of good faith and obligations such as notification, assistance, and confidentiality, etc., which may be derived from the nature and purpose of the contract as well as its relevant usage (art. 60 CL).

1. Construction of Contract Terms

In cases of ambiguity in the wording, interpretation of a contract's terms becomes 4 necessary in order to find out the true intention of the parties. Art. 125 CL sets out

the general rules for contract construction, which include the literal approach, textual approach, purposive approach, usages and practices, as well as the principle of good faith.

a. Literal Approach

- 5 Each interpretation begins by determining the literal meaning of the words used in a contract, which constitutes the basis of the interpretation. If the real intention of a party cannot be explored, a contract is to be interpreted in the natural and ordinary sense generally used by ordinary people.¹
- 6 The SPC decided in *Wanjie Hospital v Zibo Boshan Branch of the Bank of China, Zibo Boyi Fiber Co., Ltd. and Wanjie Group Co., Ltd.*², that a literal approach was the primary way to explore the intention of the parties. Only when the exact meaning cannot be identified by the literal approach, the court was allowed to employ other approaches. In the case mentioned above, Wan Jie Hospital entered into nine loan contracts with the Bank of China. The first lending contract prescribed that “all disputes which arise out of the performance of, or which related to this agreement, should be settled through negotiation. When such negotiation fails, the dispute shall be submitted to the Zi Bo Arbitration Commission for arbitration.” The other eight contracts prescribed that “all disputes which arise out of the performance of, or which related to this agreement, should be settled through negotiation. When such negotiation fails, either party can bring a lawsuit before the court at the locality of the lender.” Later, the bank brought a suit against the hospital based on these nine lending contracts. The hospital entered a plea claiming that the dispute was outside the jurisdiction of the court on the grounds of the arbitration clause in the first contract. According to the understanding of the hospital, the eight contracts are associated with the first contract; therefore, the dispute in connection with these eight contracts should also be settled through arbitration. The SPC ruled that there were no contract terms indicating an interrelationship between the first contract and the following eight contracts, and that all of these contracts were executed and performed independently of each other. As there was clearly a clause in the

¹ WANG Liming (2003), 203; HAN Shiyuan, 800.

² *Wanjie Hospital v Zibo Boshan Branch of the Bank of China, Zibo Boyi Fiber Co., Ltd. and Wanjie Group Co., Ltd.* (淄博万杰医院与中国银行股份有限公司淄博博山支行、淄博博易纤维有限公司、万杰集团有限责任公司借款担保合同纠纷管辖权异议案), judgement of the SPC dated 25th May, 2007.

remaining eight contracts, which stated that the party could bring a suit directly against the other party, the court should interpret the contract in accordance with the literal meaning of such a clause.

b. Textual Approach

A contract as a whole text is internally integrated. Therefore, in order to analyze and 7 judge the meaning of a term or provision in a contract, one must take into account the connection between various provisions in the whole contract instead of construing the term or provision insulated from its context. When two different interpretations are available, of which one is likely to lead to contradictions between different clauses and the other is not, then the latter is preferable. In this aspect, Chinese contract law follows the same approach in the PICC, which states in art. 4.5 that “contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect”.

In the case *Xiamen Jia Shun Design and Decoration Engineering Co., Ltd. v Shihua 8 Real Estate Development Co. Ltd.*³, the appellant, a property seller, and the appellee, a developer, signed an exclusive property underwriting contract. Under the contract, the appellant should pay the appellee two million RMB in the form of two instalments as part of a security deposit for the performance of the contract. One million RMB would be paid within the first five working days after the conclusion of the contract, and the other million RMB would be paid off within one month after the issuance of a sales permit by the proper authority. In the case that the second instalment of the deposit was delayed by more than three working days, the appellee is entitled to terminate the contract and confiscate the first instalment. The appellant did not however get the sales permits for the whole estate project at once, but rather obtained three different sales permits at three different times for the 19 buildings. Doubt arose about the meaning of the sales permit indicated in the contract. The appellee insisted that the appellant should pay the second installment of deposit when he got the first sales permit. Since the appellant did not pay the second deposit instalment, the appellee was able to terminate the contract and retain the first instalment. The appellant raised the defence that only when the

³ *Xiamen Jia Shun Design and Decoration Engineering Co., Ltd. v Shihua Real Estate Development Co., Ltd.* (厦门东方设计装修工程有限公司与福建省实华房地产开发有限公司商品房包销合同纠纷案), judgement of the SPC dated 19th September, 2005.

appellee got the sales permit for the whole real estate project had he the duty to pay the second deposit. The SPC explored the true meaning of this agreement on the basis of the full text of the contract and the whole process of the transaction between the parties at issue. There was another clause in the contract, which stipulated that the appellee should get the sales permit for the whole project before a specific date. The court decided that this provision was very helpful in interpreting the contract. When the appellee notified the appellant that he got the first sales permit for several of the buildings, the appellant had pointed out that the sales permit was only for a set number of specific buildings rather than for the whole project. The SPC upheld the plea of the appellant and emphasized that the interpretation of the contract should be in accordance with the text of the contract, instead of merely emphasizing the difference in wording.

c. Purposive Approach

- 9 The purposive approach requires that the interpretation of the contract terms is in line with the purpose of the contract. If two possible meanings may be reasonably ascertained as a result of the interpretation of a contract based on the language used, the one that is able to best serve the purpose of the contract will prevail. For example, if two different meanings can be deduced from the text of the contract, one of which may render the contract or the term valid, and the other of which renders it invalid, the former one will prevail. This is because it is to assume that the parties intended to enter into a valid contract rather than a void contract.
- 10 In *Zhaozhuang Mineral Company Caili Coal Mine v Qingdao Branch of the Huaxia Bank and Qingdao Free Trade Zone Huadong International Trading Company*⁴, these three parties executed an agreement on a cooperative business operation regarding wood import. Caili Coal Mine was responsible for providing ten million RMB as a security deposit for an import Letter of Credit (L/C) and Huadong Company was responsible for applying for the L/C. When applying for the L/C, Huadong Company should get a written consent from Caili Coal Mine. The bank could only issue the L/C when written consent was presented. The proceeds from

⁴ *Zhaozhuang Coal Mine Group Co., Ltd. v Qingdao Branch of the Huaxia Bank and Qingdao Free Trade Zone International Trading Co., Ltd.* (枣庄矿业集团有限公司柴里煤矿与华夏银行股份有限公司青岛分行、青岛保税区华东国际贸易有限公司联营合同纠纷案), judgement of the SPC dated 15th April, 2010.

the wood sales should be deposited into a new bank co-account set up by Caili Coal Mine and Huadong Company and supervised by the bank. Caili Coal Mine delivered a bill of exchange to Huadong Company. Huadong Company did not import the wood but used the money for other business. Caili Coal Mine filed a suit against the bank, blaming it for the non-performance of the duty to supervise the use of the money.

The key problem in this case regards whether the bank has the duty to supervise 11 the funds. The SPC held that Caili Coal Mine did worry about the security of the funds and consequently designed a contract clause with the purpose to safeguard the funds, which explicitly stated that written consent from Caili Coal Mine was absolutely necessary when the bank addressed the application for the L/C. Nevertheless, the purpose of the contract is not to be interpreted in accordance with one party's expectation, but rather in accordance with the common purpose of the contracting parties as understood by a reasonable person. For this reason, the bank's duty was determined to be limited to the explicit provision rather than the scope constructed on the basis of intent of Caili Coal Mine.

d. Usages and Practices

Ascertaining the meaning of a contract by reference to trading usages (交易习惯) 12 and practices (交易行为) is a widely recognized principle for contract construction. Similar to the CISG⁵ and the PICC⁶, under the CL, "trading usages and practices" can be the usage agreed upon by the parties or the practices established between the parties. A usage, which is commonly adopted at the place of the trade, a certain field, or a certain industry and is known or should be known by the trading parties at the time of concluding the contract, is also to be recognized as a "trading usage and practice".⁷ With respect to trading usages and practices, the party claiming such customs bears the burden of proof.⁸ Note that the "trading usages and practices"

⁵ Art. 9 (1) of the CISG provides that "the parties are bound by any usage to which they have agreed and by any practices they have established between themselves." Furthermore, Art. 9 (1) of the CISG provides that "parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned."

⁶ Art. 1.8 PICC.

⁷ Art. 7 (1) of the Interpretation of the CL (Part II).

⁸ Art. 7 (2) of the Interpretation of the CL (Part II).

approach is subject to two limitations: (i) a usage or practice that violates mandatory provisions of laws and administrative regulations is irrelevant, (ii) parties may exclude the applicability of usages and practices as a construction method. The usages and practices must also not contradict any express term of the contract.

- 13** The SPC applied the usages approach in the case of *Yan Chunmei v Zhu Guoqing*. The contract between both parties stipulated that the plaintiff is obligated to transfer a feed technology to the defendant, and the defendant is obligated to pay the plaintiff the technology transfer fee. The defendant will set up a company and use the technology to produce feed. However, the contract also specified that all the assets of the company belonged to the defendant who held a 65 percent stake in the company, while the plaintiff held a 25 percent stake. The plaintiff considered the contract as a joint venture contract and the defendant took the opposite position by regarding the contract as a simple transfer of technology. In addition to other contract interpretation approaches, the SPC pointed out that, with respect to trading usages, royalty payment in the form of profit sharing plus advance payment of initial fees are common in technology transfers. Therefore, the formulation of the plaintiff's interest of the company is in fact part of the provision on royalty payments in the form of profit sharing. That is to say, the plaintiff had the right to draw 25 percent of the company's profit as part of the royalty payments.⁹

e. Principle of Good Faith

- 14** The principle of good faith is one basic principle of contract law, which also applies to the interpretation of contract terms. When interpreting a contract, the principle of good faith requires that conflicts between parties are properly solved and that shared interests are adequately balanced.
- 15** In *Dai Xuefei v Huaxin Company*, both parties agreed that the plaintiff pays the defendant, a developer, RMB 50,000 as a form of deposit to place an order for an apartment. If the plaintiff does not sign the formal apartment sales contract with the defendant before 25th April, the defendant will be entitled to retain the deposit. When the plaintiff was about to sign the formal contract, she found that there was a standard term in the contract, which specified that the sample apartment was merely

⁹ *Yan Chunmei v Zhu Guoqing* (闫春梅与朱国庆技术转让合同纠纷案), judgement of the SPC dated 25th May, 2009.

for reference and that the company reserves all rights regarding the interpretation of the contract. The plaintiff put forward a proposal to modify the contract provision, which would require the decoration standards of the apartment to be the same as those of the sample apartment. It also required the defendant to delete the clause about contract interpretation. Since the defendant did not agree with the proposal, both parties did not sign the contract. Several days later, the defendant informed the plaintiff that the deposit had been retained due to the plaintiff's violation of the pre-contract. The SPC ruled that it is grossly unconscionable for the defendant to adopt a clause in the contract with regard to the sample apartment and interpretation of the contract. The plaintiff's dissent was reasonable. Based on the principle of good faith, the pre-contract could not be interpreted in a way so that the defendant could retain the deposit under any circumstance so long as the formal contract has not yet been concluded.¹⁰

2. Gap-Filling

In the case that the parties fail to fully express their intent in words, courts are **16** allowed to “fill in the gaps” in accordance with art. 62 CL if a contract term is neither clearly worded nor identifiable through contract interpretation. Art. 62 CL covers gap-filling rules with respect to quality, price, place, time, method, and expenses of performance (*infra* Chapter 9 at 8-9).

3. Defence

In order to protect the interest of the obligor, the CL permits the obligor to suspend **17** his performance on the following occasions:

a. Defence of Simultaneous Performance

Art. 66 CL grants each party the defence of simultaneous performance with respect **18** to bilateral contracts (双务合同) where the parties are mutually obligated and the order of performance is not specified in the contract. Parties to unilateral contracts are not entitled to invoke this defence. The defence of simultaneous performance applies only when one party does not carry out its principal obligation under the

¹⁰ *Dai Xuefei v Huaxin Co., Ltd.* (戴雪飞诉苏州华新国际公司房屋买卖预约合同定金纠纷案), judgement of the Suzhou Intermediate Court dated 18th May, 2005.

contract. In general, if one party has carried out its principal obligation but, fails to fulfill its other subordinate obligations, then the other party is not allowed to refuse to perform its own principal obligations because there is usually no corresponding relationship between the subordinate obligation of one party and the principal obligation of the other party.¹¹

b. Defence of Consecutive Performance

- 19** Art. 67 CL permits the party who is to perform subsequently to withhold its performance until the performance of the party bearing the duty to perform first in a bilateral contract, where there is an agreement on the order of performance. This defence may be triggered also by the non-conforming performance of the party bearing the duty to perform first.

c. Defence of Safety

- 20** Art. 68 CL codifies the defence of safety. The party bearing the duty to perform first in a bilateral contract is allowed to suspend its performance if it has conclusive evidence establishing that the other party is in any of the following circumstances: (1) its business has seriously deteriorated, (2) it has engaged in a transfer of assets or withdrawal of funds for the purpose of evading debts, (3) It has lost its business creditworthiness, (4) it is in any other circumstance which will or may cause it to lose its ability to perform. Where a party suspends its performance without conclusive evidence establishing that the other party is in any of the listed circumstances, it is liable for a breach of contract. If a party invokes the defence of safety, it must timely notify the other party. Should the other party provide appropriate assurance for its performance, the first party will be required to resume performance. After performance is suspended, if the other party fails to regain its ability to perform and fails to provide appropriate assurance within a reasonable amount of time, then the suspending party may terminate the contract. Usually the defence of safety operates by entitling the party to defend itself against the other party's performance requirement. However, the SPC has enacted a rule which states that, if one party has fulfilled its own obligation while the other party's payment is not due and there is conclusive evidence establishing that the other party expressly stated or indicated by its conduct that it will not perform its payment obligations, or the business license

¹¹ *SHI Jianhui*, 44-50; *WANG Chuang* (2007), 15-18.

of the debtor has been revoked, or the debtor has engaged in a transfer of assets or withdrawal of funds for the purpose of evading debts, then a court may determine that the payment becomes due prior to maturity.¹²

The defence of safety is criticized for clashing with the provisions of an anticipatory breach as provided in Art. 94 para. 2 CL.¹³ In fact, the defence of safety deals with the situation in which one party cannot guarantee that a breach is inevitable. If the breaching party clearly declares that it will not perform the contract, then there is no need to invoke the defence of safety. On this occasion, the innocent party is entitled to claim remedies for a breach of contract rather than the right to withhold its own performance. **21**

II. Amendment of Contracts

Chinese contract law also follows the *pacta sunt servanda* principle that “performance must be tendered as long as it is possible and regardless of the burden this may impose on the performing party”, as stated in the PICC¹⁴. Art. 8 CL forbids arbitrary amendments to and rescission from a contract. A unilateral amendment of a contract is allowed only when the contract or law provides this. **22**

Art. 77 para. 1 CL permits amendments to a contract by mutual agreement. If an amendment to a contract is subject to approval or registration, such a provision applies (art. 77 para. 2 CL). When the amendment is unclearly worded, the contract term can be construed as not having been amended pursuant to art. 78 CL, which means that an ambiguous amendment remains invalid. Except for mutual consent, a party is allowed to apply with the court for a modification only when the contract is affected by a mistake or unconscionability as set out in art. 54 CL. **23**

III. Change in Circumstances

Apart from these two exceptions, the CL itself contains no other provision on the unilateral adaptation of a contract.¹⁵ During the legislative process of contract law, the concept of “change in circumstances” had been introduced into the draft. However, some NPC delegates expressed their concern that the adoption of a **24**

¹² Art. 17 of Opinions on Trials under the Current Situation.

¹³ ZHENG Yunrui, 37.

¹⁴ Comments of the PICC on Art. 6.2.1 (Contract to be observed).

¹⁵ Gu Angran, 34.

provision on unilateral modification, even under very limited circumstances, would undermine the binding character of a contract. Thus, the concept of change in circumstances, which allows unilateral modification of a contract, was finally deleted from the CL.¹⁶

- 25** From the perspective of comparative law, the doctrine of change in circumstances is recognized both in the common law system¹⁷ and the civil law system¹⁸. The PICC summarizes that “*the phenomenon of hardship has been acknowledged in various legal systems under the guise of other concepts such as frustration of purpose*”.¹⁹ In modern society, change becomes the norm. Changes may lead to contract disputes as they are beyond the expectation of the contracting parties and consequently the contract does not prescribe how to deal with the changes. The judicial authority has long been deeply plagued by such disputes. Against the background of a global financial crisis, litigations of this nature increase quickly.²⁰ It is thought that the introduction of the doctrine of change in circumstances serves the purpose of providing legal remedy when the balance of both parties’ interest has been significantly destroyed by substantial changes.²¹ Therefore, eight years after the CL was put into effective, the SPC finally acknowledged this concept in a judicial interpretation. This step is regarded as significant progress in the development of the CL.
- 26** A change in circumstances refers to a material change in circumstances occurring after the contract has been concluded. It is required that the material change is unforeseeable to the parties at the time of the contract conclusion. If the change

¹⁶ Legal Committee of the 9th NPC, 3.

¹⁷ Common law establishes the doctrine of “frustration”. Lord Simon enunciated in *National Carriers v Panalpina* that frustration arises out of a situation where “there supervenes an event (without default of either party and for which the contract makes no sufficient provisions), which so significantly changes the nature (not merely the expense of onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution and that it would be unjust to hold them to the literal sense of its stipulation under the new circumstances”.

¹⁸ Art. 313 of the German civil code stipulates that if circumstances upon which a contract was based have materially changed after the conclusion of the contract and if the parties would not have concluded the contract or would have done so upon different terms had they foreseen the change or modification of the contract, the parties may claim in so far as having regarded all circumstances of the specific case, in particular, the contractual or statutory allocation of risk. Thus, it cannot reasonably be expected that a party should continue to be bound by the original contract. German civil code further provides that if modification of the contract is not possible or cannot reasonably be expected of one party, then the disadvantaged party may rescind the contract.

¹⁹ Comments the PICC on art. 6.2.1.

²⁰ WANG Chuang, (2009), 5-6.

²¹ LIU Lan, 4; CAO Shouye, 44-49.

could have been foreseen by the disadvantaged party, he is barred from invoking the doctrine of change in circumstances. When deciding whether a major objective change amounts to a change in circumstances, the court will take into account factors such as whether the type of risk is unforeseeable in common sense and whether the degree of risk is far beyond the reasonable expectation of a normal person.²²

Although the SPC's interpretation does not expressly require that the change is 27 beyond the control of the disadvantaged party in contrast to art. 6.2.2(c) PICC, there is an indication that whether the risk could have been prevented and controlled is one of the factors in determining whether a change constitutes a change in circumstances²³.

Thirdly, a material change is a change that does not belong to commercial risks, 28 which the disadvantaged party assumes. Commercial risks are inherent in business activities, irrespective of whether the parties to a contract were aware of them at the time of entering into the contract. Material changes in circumstances do not include commercial difficulty, such as changes in supply and demand, price changes not reaching the level of abnormal changes. The purpose of the provision of change in circumstances is to ease the disadvantaged party's burden rather than encourage opportunism. The doctrine of change in circumstances is generally inapplicable to contracts concerning bulk commodities such as oil, coke, and nonferrous metals and risk investment types of financial products such as stocks and futures.²⁴

Fourthly, a material change in circumstances is a change that leads to obvious 29 unfairness or the frustration of a contract's purpose. Unfairness may be reflected in the increase in cost of one party's performance or the decrease in value of the performance received by one party.

The principle of "change in circumstances" does not work to relieve the debtor from 30 obligations and let the creditor bear adverse consequences, but to fairly and reasonably adjust the interest relations between both sides in order to strike a balance of interests. The disadvantaged party is entitled to request renegotiations,

²² Art. 3 of Opinions on Trials under the Current Situation.

²³ Art. 3 of Opinions on Trials under the Current Situation.

²⁴ *WANG Chuang* (2009), 6.

although the judicial interpretation does not clearly provide it.²⁵ Upon failure to reach a new agreement, one party is allowed to resort to the court for the alteration or rescission of the contract. The court is not authorised to apply the doctrine of change in circumstances *ex officio*, but has to order the parties to first renegotiate and revise contracts. If the renegotiation fails, the court will be required to try and solve the dispute through mediation.²⁶ If mediation also fails, the court will be allowed to determine the permissibility of an alteration or rescission of the contract according to the principle of fairness and in line with the actual conditions of the case. The adaptation or termination of the contract is limited to the relevant terms affected by a material change in circumstances rather than all clauses of the contract. A court must first report to a higher court and secure approval before it renders a decision based on the doctrine of change in circumstances in order to maintain the normal order of market transactions.²⁷

- 31 Major events such as global or regional war, natural disasters, economic crises, and significant adjustments of state economic policy can be regarded as material change.²⁸ Change in circumstances as an independent doctrine also aims to deal with other situations of force majeure, although both are unforeseeable for the party. The result of force majeure is that the performance of the contract is impossible, while change in circumstances primarily leads to severe an imbalance in the interests of both parties rather than the impossibility of performance.²⁹
- 32 The principle of “change in circumstances” aims to meet exceptional circumstances rather than usual situations; thus, this doctrine is not frequently applied in judicial practice. Nevertheless, the fact that this doctrine has been adopted in main legal systems helps prove the value of this principle. As early as 1986, a judicial interpretation stipulates that when the economic plan which is the basis of the rural management contracts (农村承包经营合同) is cancelled or adjusted, or the tax or price policy has been changed, then the rural management contract may be

²⁵ WANG Chuang (2009), 5-6.

²⁶ Art. 4 of Opinions on Trials under the Current Situation.

²⁷ Art. 2 of the Notice of the SPC on Correctly Applying Interpretation II to Issues concerning the Contract Law of the People's Republic of China so as To Serve the Primary Objectives of the Party and the State (最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(二) 服务党和国家的工作大局的通知), promulgated on 27th April, 2009 and effective from 27th April, 2009 (hereinafter: Notice on Correctly Applying Interpretation II).

²⁸ LI Guohui, 12; WANG Chuang (2009), 5.

²⁹ CAO Shouye, 49; HAN Shiyuan, 443-444.

amended or terminated.³⁰ In 1992, in a dispute between the Wuhan Gas Company and the Chongqing Instrument and Meter Factory over a sales contract concerning gas meter parts, the SPC pointed out that substantial changes had emerged, which resulted in an obvious injustice, so the contract could be amended or terminated.³¹ In 2001, in a dispute over a property sales contract between the Hainan Province Haikou City Binhai Entertainment Company and the Hainan Huaxin Property Company, the SPC ruled that the state policy on the real estate market had changed, which was beyond the expectations of the contracting party; thus, the contract could be terminated.³² These cases demonstrate that without the doctrine of change in circumstances, it would be impossible to solve such disputes in a fair and reasonable way. In a changing society, this doctrine certainly has its own place. However, as mentioned above, this principle should not be applied widely and/or optionally.³³

IV. Assignment and Delegation

1. Assignment of Contractual Rights

In principle, the obligee may assign its rights under a contract in whole or in part to a **33** third person except for cases where such assignment is prohibited.³⁴ Firstly, this prohibition may lie in the nature of the contract. For example, the performance of one artist cannot substitute for the performance of another artist. Secondly, the prohibition may be set out by an agreement directly between the parties because the parties do not want to deal with an outsider. The CL contains no statutory provision on the exclusion of assignment. As is the case with the amendment of a

³⁰ Art. 10 of the Opinions of the SPC on Issues in Trials of Rural Land Contracts (最高人民法院关于审理农村承包合同纠纷案件若干问题的意见), promulgated on and effective from 14th April, 1986; abolished on 28th June, 1998.

³¹ Letter of the SPC on the Application of Law in the Gas Meter Technology Contract Dispute between Wuhan Gas Company and Chongqing Instrument and Meter Factory (最高人民法院关于武汉市煤气公司诉重庆检测仪表厂煤气表装配线技术转让合同购销煤气表散件合同纠纷一案适用法律问题的函), promulgated on and effective from 6th March, 1993. In this case, the state pricing of aluminium, which is the main raw material for producing gas meters, had been adjusted from 4400-4600 per ton to 16000 per ton, and the price of aluminium shell also rose sharply.

³² *Binhai Entertainment Co., Ltd. of Haikou City, Hainan Province v Hainan Huaxin Realty Management Co., Ltd.* (海南省海口市滨海娱乐有限公司与海南华信物业公司房屋买卖合同纠纷案), judgement of the SPC dated 16th May, 2001.

³³ To control the application of this doctrine, if the court holds it necessary to apply this doctrine in a specific case, it shall be reviewed in advance by the high people's court and even the SPC. Art. 2 of the Notice on Correctly Applying Interpretation II.

³⁴ Art. 79 CL.

contract, the assignment of contractual rights has to also abide by any applicable approval or registration requirement.³⁵

34 The assignor bears the duty to inform the obligor.³⁶ An assignment is not binding upon the obligor before such a notice reaches him. A notice of an assignment of rights given by the assignor may not be revoked, except with the consent of the assignee.³⁷ Upon conclusion of the assignment contract, the assignee accedes to the position of the assignor. The assignee assumes any incidental rights associated with the assignor's right, except where such incidental rights are exclusively personal to the assignor.³⁸ Often, the rights which are personal to the assignor can refer to the right of formation (形成权), e.g. the right of cancellation. For example, only the assignor who is the victim of fraud has the right to cancel the contract. The assignee has no right to cancel the contract.³⁹ The defences available to the obligor against the assignor remain unaffected by the assignment.⁴⁰ The same applies to the right to set-off available to the obligor with regard to the assignor.⁴¹

2. Delegation of Contractual Obligations

35 According to art. 84 CL, delegation of contractual obligations is subject to the consent of the obligee. In cases of a delegation, the new obligor accedes to the position of the previous obligor. That means, the new obligor can use the same defences available to the previous obligor against the obligee and shall assume any incidental obligations associated with the main obligations towards the obligee, except when such incidental obligations are exclusively personal to the original obligor.⁴²

³⁵ Art. 87 CL.

³⁶ Art. 80 para. 1 CL.

³⁷ Art. 80 para. 2 CL.

³⁸ Art. 81 CL.

³⁹ *HAN Shiyuan*, 557.

⁴⁰ Art. 82 CL.

⁴¹ Art. 83 CL.

⁴² Arts. 85, 86 CL.

3. Concurrent Assignment and Delegation

Upon consent by the other party, one party may concurrently assign its rights and 36 delegate its obligations under a contract to a third person.⁴³ In cases of a merger or division, the legal successor of the original contract party assumes the original contractual rights and obligations.⁴⁴

V. End of a Contract

According to art. 91 CL a contract may end by performance, rescission, set-off, 37 escrow, release and merger of rights and obligations.

1. Rescission

Except voluntary rescission by the parties, art. 94 CL gives contracting parties a 38 statutory right to rescind a contract in the following circumstances: (1) *force majeure*, or (2) *in a fundamental breach of contract*. When force majeure frustrated the purpose of the contract, the contracting parties may both rescind the contract (*infra* Chapter 7 at 3). In cases of a fundamental breach of contract, the innocent party is entitled to unilaterally rescind the contract. A breach will be considered as fundamental if the defaulting party delays performance or tenders an unsatisfying performance and the default frustrates the purpose of the contract, or the defaulting party delays performance of its main obligations and fails to perform within a reasonable time after receiving a demand for performance, or the defaulting party expressly states or indicates by its conduct that it will not perform its main obligations before the time of performance.⁴⁵

According to art. 95 CL, the right of rescission must be exercised in a timely manner, 39 meaning, within the period agreed upon by the parties, stipulated by the law, or within a reasonable time after receiving the demand from the other party; otherwise, it extinguishes. The right of rescission does not need to be exercised through a lawsuit; a party notice suffices.⁴⁶ The contract is rescinded when the notice reaches the other party. If the other party objects to the rescission, he will have to do it in a

⁴³ Art. 88 CL.

⁴⁴ Art. 90 CL.

⁴⁵ Art. 94 CL.

⁴⁶ Art. 96 CL.

timely manner before the court, which means filing a lawsuit either within three months upon receipt of the rescission notice or within the period of time agreed upon by the parties.⁴⁷ Some judges argue that when the other party petitions the court or arbitration institution to affirm the validity of the rescission, it is to assume that the contract is rescinded on the date when the decision is rendered. If the contract is assumed to have been rescinded when the notice reaches the other party and the parties begin to restore the subject matter to its original condition, after which the court rules the issue oppositely, unnecessary loss may be caused.⁴⁸ However, this position is not supported by art. 96 CL, which expressly prescribes that a contract is rescinded once the notice of rescission arrives. Furthermore, if the other party disagrees with the rescission, restitution will not take place. Therefore, the worry of a loss caused by restitution is unnecessary. The party that is entitled to rescind the contract may also terminate a contract outright in a suit without prior notice to the other party.⁴⁹ With respect to this situation, the date on which the copy of the complaint is served on the defendant can be regarded as the starting point of the rescission.⁵⁰ As there is no obligation for prior notice from the party who decides to rescind the contract under this circumstance, the other party first becomes aware of the rescission once the copy of the complaint is served. The function of the complaint is the same as the prior notice. Upon rescission of a contract, any unrendered performance is discharged. According to art. 97 CL, if a performance has been rendered, a party may request restoration of the original conditions for the performance and is entitled to claim damages. The CL and the Law of Protection of Consumer Rights and Interests⁵¹ do not grant consumers a special statutory right of revocation.

2. Set-off

- 40** Parties to a contract will be entitled to set-off their obligation in accordance with art. 99 para. 1 CL if both obligations are due and the subject matter of the obligations are identical in type and quality, except where a set-off is prohibited by law or in light

⁴⁷ Art. 24 of the Interpretation of the CL (Part II).

⁴⁸ *Li Guohui*, 11.

⁴⁹ *Cui Jianyuan/Wu Guangrong*, 16; *ZENG Xiangsheng*, 149-150.

⁵⁰ *Cui Jianyuan/Wu Guangrong*, 16-17; *XUE Wencheng*, 152-160.

⁵¹ 消费者权益保护法, promulgated on 31st October, 1993 and effective from 1st January, 1994; last revision effective from 27th August, 2009.

of the nature of the contract. Obviously, if only one party's obligation is due, only the party whose obligation is not due can make a set-off proposal. If the subject matter of the obligations is not identical in type and quality, then the parties may put a set-off into effect by mutual agreement. In cases of a set-off, a notice is to be given to the other party. The notice becomes effective when it reaches the other party.⁵² A set-off notice may not be subject to any condition or time limit. If the other party disagrees with the set-off, he will have to do it in a timely manner as in the case of objections to termination of an agency relationship (*supra* Chapter 2 at 43 *et seqq.*). It is to note that Chinese bankruptcy law specifies cases in which a set-off is prohibited. A claim obstructed by such a defence means that the opposing party's obligation is not due. Therefore, under Chinese contract law this kind of claim may not be set-off either. Furthermore, an unpledgeable claim cannot be set off because of the nature of the claim. Claims in tort are also illegible for a set-off.

3. Escrow

According to art. 101 para. 1 CL the obligor will be allowed to place the subject 41 matter in escrow if (i) the obligee refuses to take delivery of the subject matter without cause, (ii) the obligee cannot be located, (iii) the obligee is deceased or has lost civil capacity and his heir or guardian has not yet been determined, (iv) any other circumstance provided by law occurs. When the subject matter is not fit for escrow, or the escrow expenses would be excessive, the obligor may auction or liquidate the subject matter and place the proceeds in escrow pursuant to art. 101 para. 2 CL.

After placing the subject matter in escrow, the obligor has the duty to timely notify 42 the obligee or his heir or guardian, except when the obligee cannot be located.⁵³ Once the subject matter is in escrow, the risk of its damage or loss is borne by the obligee, the fruits of the subject matter accrued during escrow belong to the obligee, and the escrow expenses are born by the obligee.⁵⁴

The obligee may retrieve delivery of the subject matter in escrow at any time within 43 the first five years after it has been placed in escrow. Otherwise, the subject matter

⁵² Art. 99 para. 2 CL.

⁵³ Art. 102 CL.

⁵⁴ Art. 103 CL.

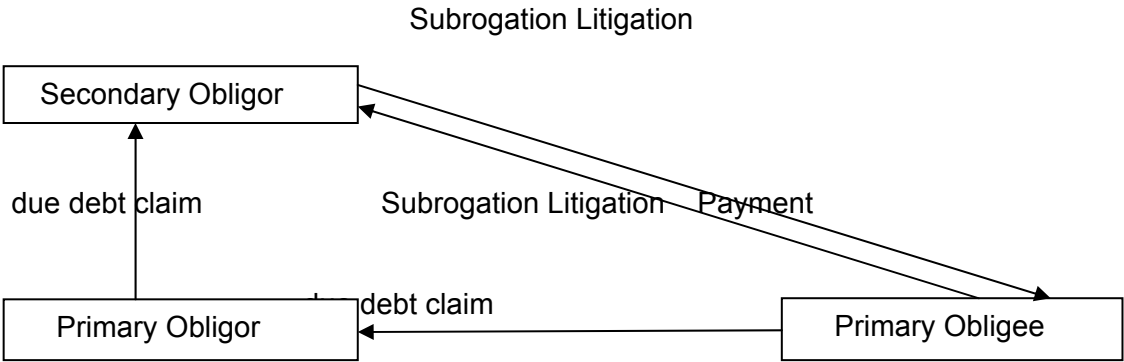
is to be turned over to the state. Provided that the obligee owes some kind of performance toward the obligor that is due, prior to the obligee's performance or provision of assurance, the escrow agent is obligated to reject the obligee's claim to the subject matter as required by the obligor.⁵⁵

4. Legal Consequences of Termination

44 When the contract relation is ended, the contractual rights and obligations are discharged, which nonetheless does not affect the validity of the contract provisions concerning the settlement of an account and winding-up. Art. 92 CC specifies that upon discharge of the rights and obligations under a contract, the parties are to abide by the principle of good faith and perform their obligations such as notification, assistance, and confidentiality, etc. in accordance with the relevant usage. When one party violates an obligation, as stipulated in art. 92, and causes losses to the other party, the other party is entitled to claim damages.

VI. Right of Subrogation

45 Art. 73 CL states that “when the obligor is delayed in exercising its due debt claim, thereby harming the obligee's interests, the obligee may petition the court for in order to realize the obligator's rights against a third party in his own name; however, the debt claim exclusively belongs to the obligor. The scope of the right of subrogation shall not exceed the debt claim of the obligee. Any costs incurred for exercising the right of subrogation shall be borne by the obligor.”



55 Art. 104 CL.

1. Prerequisites of Subrogation Rights

It can be concluded from art. 73 CL that subrogation rights are subject to the **46** following prerequisites:⁵⁶

(1) The primary obligee's debt claim against the primary obligor is lawful. For this **47** purpose, the primary obligee does not need to get a court decision to confirm the legality of his debt claim. It is controversial whether the primary obligee's right is limited to debt claims (债权).⁵⁷ The most restrictive construction sees the scope of subrogation rights limited to contractual rights, although it is generally acknowledged that subrogation rights also apply to other types of obligation rights and not just contractual claims, such as claims in tort.⁵⁸ In practice, some courts hold the position that real security rights qualify for subrogation.⁵⁹ Some even argue that almost all types of rights, including real rights, and rescission rights, etc., can be subrogated since these rights may affect the primary obligor's assets, which directly determine whether the claim of the primary obligee can be fully realized.⁶⁰ Some oppose this opinion and insist that it is important not to excessively enlarge the scope of potentially subrogated rights.⁶¹

(2) The primary obligor's delay in exercising his due debt claim has caused harm to **48** the primary obligee. This prerequisite refers to the primary obligor's failure to enforce his debt claim through official legal channels such as court or arbitration proceedings, which frustrates the primary obligee's realization of his debt claim.⁶² In other words, even if the primary obligor has asserted his debt claim against his own debtor through private means, he will be deemed to have failed in exercising his debt claim because no official legal channel was employed.⁶³ In addition, a delay of the primary obligor causes harm to the primary obligee. If the primary obligee's rights are secured, the delay of the primary obligor would unlikely harm the interest of the primary obligee. Therefore, the secured creditor is not entitled to the right of

⁵⁶ Art. 11 of the Interpretation of the CL (Part I).

⁵⁷ *Li Guohui*, 11.

⁵⁸ *Liu Ziping/Wu Xingzheng*, 19-34.

⁵⁹ *ZHONG Kewei*, 42-53.

⁶⁰ *Li Guohui*, 11; *WANG Liming* (2003), 458.

⁶¹ *Li Guohui*, 11.

⁶² Art. 13 of the Interpretation of the CL (Part I).

⁶³ *WANG Liming* (2001), 36-45; *WANG Liming* (2003), 467.

subrogation.⁶⁴ It is to note that the SPC confines the scope of a debt claim by the primary obligor to a monetary claim.

- 49 (3) Both the primary obligor's and the primary obligee's debt claim are due.⁶⁵ While scholars generally admit that if it is necessary for the obligee to preserve the right of the primary obligor, then this requirement can be loosened and limited to the debt claim of the primary obligor.⁶⁶ For instance, the creditor can exercise the primary obligor's right in order to interrupt a statute of limitations or declare the right of the primary obligor when the secondary obligor is insolvent, even though the primary obligor's or the obligee's debt claim is not yet due.
- 50 (4) The claim of the primary obligor is not exclusively personal. A personal debt claim could be a claim for alimony, child support, parental support or succession, a claim for wages, a retirement pension, an old age pension, death benefits, relocation allowance, life insurance, or a personal injury claim.⁶⁷

2. The Procedure of Exercising Subrogation Litigation

- 51 The primary obligee is only allowed to sue either the primary obligor for breach of contract or the secondary obligor, as based on art. 73 CL.
- 52 If the primary obligee first chooses to sue the primary obligor, he would be allowed to subsequently bring an additional suit against the secondary obligor before the same court.⁶⁸ In this case, the court would have to combine both cases.⁶⁹ However, the primary obligor is barred from claiming a difference in the amount owed to him and the amount claimed by the primary obligee from the secondary obligor in the proceeding initiated by the primary obligee against the secondary obligor.⁷⁰ In order to claim the difference, the primary obligor would have to bring a separate suit before the competent court. This proceeding will be postponed until the final judgment on the suit of subrogation enters into effect.⁷¹

⁶⁴ *Liu Ziping/Wu Xingzheng*, 20-21.

⁶⁵ Art. 11 and 13 of the Interpretation of the CL (Part I).

⁶⁶ *HAN Shiyuan*, 378; *WANG Liming* (2003), 465.

⁶⁷ Art. 12 of the Interpretation of the CL (Part I).

⁶⁸ Art. 15 para. 1 of the Interpretation of the CL (Part I).

⁶⁹ Art. 15 para. 2 of the Interpretation of the CL (Part I).

⁷⁰ Art. 22 para. 1 of the Interpretation of the CL (Part I).

⁷¹ Art. 22 para. 2 of the Interpretation of the CL (Part I).

If the primary obligee first chooses to sue the secondary obligor, the court would be authorised to join the primary obligor *ex officio*. Where two or more primary obligees separately sue the same secondary obligor, these proceedings may be combined.⁷² The secondary obligor is entitled to invoke any defence available to the primary obligor against the primary obligee as well.⁷³ Apart from that, the secondary obligor may raise the defence that there is no delay of the primary obligee in exercising its creditor's due rights. In this respect, the secondary obligor bears the burden of establishing this fact.⁷⁴ **53**

In cases where the right of subrogation is sustained by the court, the secondary obligor is to deliver the payment directly to the primary obligee. Thereby, the debt claims between the primary obligee and the primary obligor and the debt claim between the primary obligee and the secondary obligee are extinguished. The court fees are to be borne by the secondary obligor and have priority when paid in part of the enforced primary obligor's right. **54**

The right of subrogation is closely connected to the legal system of enforcement. For instance, in German or Swiss civil law, there is no need for an independent rule regarding subrogation. When the primary obligor delays exercising his debt claim, the primary obligee can apply with the court to enforce the primary obligor's right. On the contrary, French civil law uses the right of subrogation to make up the gap in civil enforcement law.⁷⁵ **55**

VII. Right of Invalidation

If an obligor abandons his rights or disposes of his property without receiving any corresponding consideration, it may cause harm to his creditor. To avoid this situation, art. 74 CL allows an obligee to invalidate such conduct by the obligor. The scope of invalidation right is limited to the obligee's debt claim. Any costs incurred for the exercise of this right are to be borne by the obligor. **56**

⁷² Art. 16 of the Interpretation of the CL (Part I).

⁷³ Art. 18 para. 1 of the Interpretation of the CL (Part I).

⁷⁴ Art. 13 para. 2 of the Interpretation of the CL (Part I).

⁷⁵ *DUAN Kuang*, 527.

1. Preconditions of the Right of Invalidation

- 57** Preconditions for the right of invalidation are provided in art. 74 CL and include:
- 58** (1) The obligee's debt claim against the obligor is lawful. The most important element is that the subject matter of the obligee's debt claim is money; goods in kind are ineligible.⁷⁶ Contrary to requirements for the right of subrogation, the obligee's debt claim does not need to be mature.
- 59** (2) The obligor's disposal of his own property has caused harm to the obligee. This occurs when the obligor waives his debt claim against a third party on claims against the third party; it also occurs when the obligor maliciously extends the performance period for the obligor's debt claim, assigns his property without consideration or at an unreasonably low price, or buys property at an unreasonably high price.⁷⁷ How to determine whether the price is "an obviously unreasonably low price", as stipulated in the CL, is a delicate issue. According to art. 19 para. 1 of the "Interpretation on the CL" (Part II), a court should apply the general business operator's judgment at the place of the transaction and with reference to the guiding price of the price department or the market price at the time and place of the transaction among other relevant factors. A price that is 30 percent higher or lower than the guiding price or market price at the time and place of the transaction may be deemed obviously unreasonable.⁷⁸
- 60** Malice of the obligor is generally considered to be a condition for the right of invalidation, although it is not expressly specified by the CL.⁷⁹ In the event of the disposal of property at an unreasonably low price, the obligee can petition the court for invalidation of the obligor's act in order to protect a third party dealing with the obligor, however, only when the assignee is made aware.

2. The Procedure of Exercising Right of Invalidation

- 61** The right of invalidation can be exercised only through litigation.⁸⁰ Where the obligee sues the obligor, the court may include the beneficiary or assignee as an

⁷⁶ *WANG Liming*, 493; *HAN Shiyuan*, 403.

⁷⁷ Arts. 18 and 19 para. 3 of the Interpretation of the CL (Part II).

⁷⁸ Art. 19 para. 2 of the Interpretation of the CL (Part II).

⁷⁹ *CUI Jianyuan*, 163; *WANG Liming* (2002), 176.

⁸⁰ Art. 74 CL.

interested third party. The necessary expenses incurred by the obligee in enforcing his right of invalidation, such as attorney's fee and travel expenses, are to be assumed by the obligor; where the third party is also at fault, it is required to take over an appropriate share of such expenses.⁸¹ The right of invalidation must be exercised either within one year from the date the creditor knows or should have known of the improper act or within five years from the occurrence of the improper act.⁸²

3. Legal Effect of Right of Invalidation

If the court invalidates the obligor's act, then the act will be invalid *ab initio*.⁸³ Where **62** the disposal of the property is declared void, any property recovered from a third party would become the obligor's property again. The creditor who exercises the right of invalidation has no priority in satisfaction.⁸⁴ The creditor is not allowed to use the property recovered initially for settling debts owed by the obligor. On the contrary, all creditors have equal rank for demanding satisfaction of their debt.

⁸¹ Art. 26 of the Interpretation of the CL (Part I).

⁸² Art. 75 CL.

⁸³ Art. 25 of the Interpretation of the CL (Part I).

⁸⁴ HAN Shiyuan, 418; WANG Liming (2003), 519.

Chapter 7. Liability for Breach of Contract

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I. Overview

1. Definition of Breach of Contract

Chinese contract law provides several types of remedies for the aggrieved party in 1 cases of an obligee's breach of a contract duty, including specific performances, the cure of non-conforming performances, and damages. A breach of contract is defined in Chinese contract law as the failure of a party to completely perform its duties under contract. A breach of contract may be actual or anticipatory. The latter refers to the situation in which one party expressly states or indicates by its conduct that it will not perform its obligations under contract. Therefore, the other party may hold it liable for a breach of contract even before the obligation is due. It is generally believed that the relevant provision, as stated in art. 108 CL, is borrowed from the common law system.⁸⁵

2. Attribution Principle of Liability

According to art. 107 CL, the non-performing party bears the liability for a breach of 2 contract in cases of any default, irrespective of his actual fault. Thus, it is inferred from this provision that Chinese contract law adopts the principle of no-fault liability or strict liability for a breach of contract.⁸⁶ This follows the model of the common law system, the CISG and the PICC.⁸⁷ Art. 107 CL is indeed an excellent example of the influence of the CISG and the PICC on the CL. Although the concept of strict liability is obviously different from that of fault-based liability, in practice no fundamental difference may be identified between the two for the following three reasons:⁸⁸

Firstly, both attribution principles of liability recognize force majeure as a defence for 3 the breach. Even under the principle of strict liability, force majeure serves as a defence to excuse the non-performing party from the liability for breach. Art. 117

⁸⁵ WANG Liming (2003), 494, 498.
⁸⁶ GU Angran, 44-45; XIAO Xun/WEI Yaorong/ZHENG Shuna, 341-342; WANG Liming/CUI Jianyuan, 580.
⁸⁷ FANSWORTH, Legal Remedies for a Breach of Contract. 70 Colum L. Rew. 1147(1970), see WANG Liming (2003), 415; Art. 45 CISG; Art. 7.4.1 PICC.
⁸⁸ WANG Hongliang (2007), 85-95.

para. 1 CL provides that a party unable to perform a contract, due to force majeure, is exempted from liability in part or in whole according to the impact of the event of force majeure, except where otherwise provided by law. Certainly, where an event of force majeure occurred after the party's delay in performance, it is not exempted from liability. Force majeure is defined by art. 117 para. 2 CL as an objective unforeseeable, unavoidable, and insurmountable circumstance. This definition is the same as the one in the PICC. The term "unforeseeable" means that even an objectively reasonable person would not take the objective circumstance into consideration when the contract was concluded. The terms "unavoidable" and "insurmountable" mean the circumstance or its consequences may neither be avoided nor overcome.

- 4 As to the scope of force majeure, according to the mainstream scholarly view, force majeure includes three situations: (1) natural disasters, such as floods, tsunamis, earthquakes, volcanic eruptions, etc. (these events may be described with the term "acts of God" in other legal systems); (2) social abnormal events, such as a war, strike, or riot; (3) acts of the government.⁸⁹ For example, the government enacts a new law which bans a contracting party from performing the contractual duty after the contract is concluded.
- 5 Although the events listed above are usually deemed to fall within the scope of force majeure, the final criterion to judge the existence of force majeure remains to be "unforeseeable, unavoidable, and insurmountable", as stipulated by art. 117 para. 2 CL. Whether or not the specific event can be considered force majeure is to be examined based on the circumstances of a concrete case.
- 6 For example, in the case of *Zhongji Tongyong Imports & Exports Company v The Second Port Company of Tianjin Harbor*, the plaintiff's goods suffered loss, due to a windstorm, when those goods were in the custody of the defendant. In this case, the national oceanic forecast service had warned of the windstorm, but failed to point out that the windstorm would meet with the astronomical tide. Due to a 7-grade wind, the tide level was in the end 160-193 centimeters higher than usual. Waves were up one meter within the pool of the port and two meters outside the pool of the port, both exceeding the levels previous claimed by the national oceanic forecast service. The court ruled that the seawater had engulfed the wharf, ruining the

⁸⁹ HAN Shiyuan (2004), 429-432.

plaintiff's goods, because the natural disaster was aggravated by the combination of the windstorm, the astronomical tide, and high sea waves. The court ruled that this outcome was beyond the port company's ability to foresee. Thus, the port company's defence of force majeure was accepted.⁹⁰

Not all earthquakes amount to force majeure.⁹¹ Although earthquakes can be 7 predicted by today's technology, they may reach different scales of magnitude. The ones that are not large enough to cause damage would obviously not be considered force majeure. With regard to an earthquake, a contracting party in the hard-hit areas may be allowed to raise the defence of force majeure, while a party in the light-hit areas may be barred from doing so. Since parties in seismically active areas are able to invest in resources in order to fend off earthquakes, such as deploying earthquake-oriented designs or strengthening the standards of buildings, earthquakes that could have been fended off by such measures do not qualify as force majeure.

If a party is unable to perform a contract due to force majeure, it will have the duty to 8 notify the other party in a timely manner for the purpose of mitigation of loss and to provide proof of force majeure within a reasonable amount of time.⁹²

Secondly, a breach of contract due to a third party is usually barred from operating 9 as a defence in both attribution principles of liability. Even though a party's breach is attributable to the conduct of a third party, that party is nevertheless liable to the other party for breach. Any dispute between the party and a third party is to be resolved between them in accordance with art. 121 CL. For example, the vendor will be unable to deliver the goods to the buyer if his own supplier defaults or if the work to be completed by a sub-contractor does not pass the acceptable tests. In these cases, the vendor or the primary contractor may still be found in breach. In *Qin Zhangqun v Zhang Jinshui*, the defendant leased land from one villagers' group (村民小组) and subleased parts of the land to the plaintiff with the permission of the villagers' group. The plaintiff paid the total rental fee for the whole duration of the lease contract to the defendant while the defendant annually forwarded the rent to the villagers' group. One year after the contract has been concluded, the villagers'

⁹⁰ *Zhongji Tongyong Import and Export Company Co., Ltd. v Tianjin Harbour Second Stevedoring Co., Ltd.* (中机通用进出口公司诉天津港第二港埠有限公司港口作业合同纠纷案), judgement of the Tianjin High People's Court dated 13th February, 2000.

⁹¹ *YANG Lixin*, 2-9.

⁹² Art. 118 CL.

group decided to withdraw the land and designated the land as the villagers' housing site. The plaintiff made a request for the refund of the rent, which was upheld by the court, by arguing that the defendant was also in a breach of contract because he also suffered a loss as the result of the termination of the contract. However, the defendant would be able to recover the loss by filing a suit against the owner of the land.⁹³

- 10 Thirdly, under the principle of fault-based liability, the mere fact of non-performance already suffices to indicate the existence of fault unless the debtor has a legitimate defence so that the plaintiff does not need to prove the element of fault, which is exactly the same in cases of no-fault liability.

3. Election of Remedy in Tort or in Contract

- 11 A breach of contract may trigger liability in contract and in tort simultaneously. In such a situation, art. 122 Contract Law allows the plaintiff to choose between the two as the legal basis for his actions. In other words, the plaintiff is not allowed to sue concurrently. The plaintiff may modify a choice already made before the first instance trial commences.⁹⁴

II. Main issues

1. Specific Performance

- 12 The CL distinguishes between monetary specific performance and non-monetary specific performance. With regard to monetary specific performance, there is no exception. The party who fails to pay the price or remuneration is barred from raising any defence.⁹⁵ As to non-monetary specific performance, there are three exceptions:⁹⁶
- 13 (1) If the performance is impossible in law or in fact, the obligee will not be permitted to require specific performance. The performance being impossible in fact means

⁹³ *Institute of Applied Legal Studies of the SPC (2005)*, Selected Cases of People's Court, Special on Commercial and Intellectual Property Rights Cases of 2004 (人民法院案例选(2004 年商事·知识产权专辑)), 237-242.

⁹⁴ Art. 30 of the Interpretations of the CL (Part I).

⁹⁵ Art. 109 CL; *WANG Liming* (2003), 574.

⁹⁶ Art. 110 CL.

that it is impossible for the obligor or for anyone else to perform, and as a result the claim for performance is not actionable. For example, if the owner of a house sells it to multiple buyers and the house has already been transferred to one buyer, it is impossible for the owner to perform the other contracts in fact.

(2) If the subject matter of the obligation is not suitable for enforcement or the cost of performance is excessive, the obligor can refuse to perform. For instance, a publishing contract or a performance contract is not suitable for enforcement because such type of obligations is usually exclusively personal to the obligor. Enforcement of these obligations may invade the personal liberty of the obligor. The obligor may also refuse to perform so far as the performance requires excessive expenditure. The legislator codifies this exception in consideration of balancing both parties' interests.

(3) The obligee will be prohibited from requiring specific performance if he fails to do so within a reasonable period of time.

2. Defects Liability

According to art. 111 CL, in cases of non-compliance in quality, the aggrieved party may, by reasonable election based on the nature of the subject matter and the degree of loss, require the other party to repair, replace, remake, return the goods, reduce the price, or remuneration.

Art. 111 CL is construed by some scholars to the effect that Chinese contract law has adopted the rule of defect warranty, which is independent from the normal rule regarding the liability for a breach of contract.⁹⁷ Other scholars deny this way of interpreting art. 111 CL. In their opinion, there is no room for a separate rule of defect warranty. Liability for the defect of goods has been integrated into the provision of liability for a breach of contract.⁹⁸ Scholars in favor of the independence of defect warranty insist that there are three main differences between defect warranty and ordinary liability for a breach of contract. Firstly, under the rule of defect liability, the buyer has the duty to inform the seller of the defect of the goods. If the buyer fails to inform the seller, he will be barred from asserting his rights on the basis of the seller's defect warranty. The ordinary rule on liability for a breach of contract has no comparable requirement. Secondly, defect warranty exists only for a

⁹⁷ CUI Jianyuan (2006), 36-43; WANG Hongliang (2005), 72-74.

⁹⁸ WANG Liming (2001), 21-37; HAN Shiyuan (2007), 170-190.

limited period of time. A buyer is not allowed to assert warranty liability beyond a set time limit. Thirdly, types of remedy are different. Usually, ordinary types of liability for a breach include specific performance, payment of damages, or liquidated damages, while defect warranty includes the repair, replacement, remake, or return of the goods, a reduction in price, or remuneration.⁹⁹

- 18** The above arguments are not sufficiently convincing. Even the CL has a set time limit for the inspection of goods and requires the buyer to raise an objection within that period of time. No compulsory conclusion can be drawn that defect warranty constitutes a separate rule outside the general rule on liability for a breach. It can be construed that this is a special rule for sales contracts just like the law also sets an inspection period with respect to a cargo carriage contract.¹⁰⁰ “Repair, replace, and remake” are methods of specific performances. Return of the goods is in fact the buyer’s right to rescind the contract, which is not an extraordinary relief for the non-breaching party. “A reduction in price or remuneration” can be seen as a combination and variation of traditional remedies, in which the non-breaching party abandons the right to specific performance and accepts the actual performance, but requests to recover the loss between the agreed performance and the actual performance. In whole, the rule of defect warranty may be an independent rule of contract law in other jurisdictions; however, it is unnecessary to interpret Chinese contract law in the same way.

3. Liability for Damages

a. Basic Principles

- 19** (1) Full Compensation. The purpose of liability for damages is to recover the innocent party’s entire loss. Chinese contract law takes the position that the party liable for damages must restore the condition that would have existed if the circumstances obliging him to pay damages had not occurred. Thus, the aggrieved party is entitled to full compensation for the harm sustained, which includes both direct loss and any gain deprived as a result of non-performance.¹⁰¹ The aggrieved party may claim damages in addition to specific performance.

⁹⁹ Cui Jianyuan (2006), 32-43.

¹⁰⁰ Art. 310 CL.

¹⁰¹ Art. 112 CL

(2) Foreseeable Loss. Art. 113 CL states that the amount of damages is limited to **20** the likely loss resulting from a breach which was foreseen or should have been foreseen by the breaching party at the time of conclusion of the contract. This is a generally accepted rule, which is intended to confine the scope of compensation. The standard of foreseeability is defined as the foresight of a reasonable person. Just like the PICC, foreseeability relates to the nature or type of the harm, but not to its extent.¹⁰²

The case of *Xinjiang Yakun Commercial Trade Co., Ltd. v Xinjiang Jinghe Kangrui **21*** *Cotton Processing Co., Ltd.* illustrates how the rule of foreseeability is applied in practice. Yakun signed a cotton purchase and sales contract with Kangrui, which stipulated that Kangrui agreed to sell 1,370 tons of grade 2 ginned cotton to Kangrui at the price of RMB 16,900 per ton. The quality of ginned cotton should meet the relevant national standard. If there would be a dispute on the quality or weight of the cotton, then a notarial survey should prevail. On 7th January, 2004, Kangrui delivered 1173.947 tons of cotton to Yakun. According to Kangrui's record, there were 337.109 tons of grade 1 cotton and 836.838 tons of grade 2 cotton. Yakun paid RMB 19,393,348.4 for the goods as stated in the agreed price. From June 2004, Yakun began to sell the cotton to its clients in Guangdong, Sichuan, and Hubei provinces. During that time, the price of cotton had substantially plummeted. The reports of local institutes of inspection on the fibers showed that the weight and quality of the cotton did not conform to the contract. Pursuant to the notarial inspection report, the weight of the cotton was only 1,111.202 tons. Among this cotton, there were 1.618 tons of grade 2 cotton, 523.416 tons of grade 3 cotton, 564.525 tons of grade 4 cotton, and 21.643 tons of grade 5 cotton. The total income of the resale was only RMB 12,733,990.29. Yakun sued Kangrui for recovery of the loss in the amount of RMB 6,659,358.11.

The court of first instance upheld the claim of Yakun in large. Nevertheless the court **22** of first instance indicated that due to the delay in reselling the cotton in time, Yakun itself should bear 30 percent of the loss. However, the SPC reversed the decision of the court of first instance. The SPC pointed out that the damage of RMB 6,659,358.11 includes the loss caused by the market drop. The dramatic drop in the market was unforeseeable by Kangrui; therefore, Kangrui should not have to

¹⁰² HAN Shiyuan (2004), 739.

compensate for loss realted to the market decline. What the Kangrui should pay is the price disparities between the higher grade and lower grade cotton as well as the shortage of cotton.¹⁰³

- 23** (3) Contributory Fault. Although being generally accepted, Chinese contract law has not directly adopted a rule on contributory fault. A conclusion may be drawn from art. 113 CL that the scope of compensation depends on the circumstances, in particular to what extent the damage is caused by the defaulting or innocent party. If the innocent party is in part liable for the loss, then it can only claim the damage caused by the defaulting party. The SPC has acknowledged this rule in the judicial interpretation on sales contracts.¹⁰⁴
- 24** In the case of *Nie Xiaobin v Binyang County Branch of the Industrial and Commercial Bank of China*,¹⁰⁵ the court ruled that the depositor should bear part of his deposit loss due to his own faults. In this case, the plaintiff opened a savings account in the bank, obtaining a deposit book and a bankcard. The plaintiff then transferred RMB 253,900 to the savings account, which was taken by another person several days later. According to the transaction record of the bank, one person named “Li Jianguo” took RMB 250,000 from the counter of the bank, after which RMB 3,900 was taken from an ATM. The police concluded after an investigation that the ID card of “Li Jianguo” was forged. The police also presented an expert verification on the computer security system of the bank, which stated, “the password of the client was kept secret and safe”, and the possibility of taking the money with a fake bankcard and password was excluded. The higher court reasoned that the name and the number of the ID card of “Li Jianguo” were apparently inconsistent with the one of the depositor. At the same time, “Li Jianguo” did not notify the bank in advance, according to usual banking practice, when taking such a large amount of cash. When “Li Jianguo” withdrew the money, the bank failed to register the fake ID card and the power of attorney of the plaintiff, the depositor. It was the bank’s obvious fault to recklessly pay cash from the account of the plaintiff to “Li Jianguo”. The most astonishing finding in this case is the

¹⁰³ *Xinjiang Yakun Commercial Trade Co., Ltd. v Xinjiang Jinghe Kangrui Cotton Processing Co., Ltd.* (新疆亚坤商贸有限公司与新疆精河县康瑞棉花加工有限公司买卖合同), judgement of the SPC dated 12th September, 2006.

¹⁰⁴ Art. 30 of the Interpretation of Trials of Purchase and Sales Contracts.

¹⁰⁵ *Nie Xiaobin v Binyang County Branch of the Industrial and Commercial Bank of China* (聂晓斌与中国工商银行宾阳县支行储蓄存款合同纠纷案), judgement of the SPC dated 19th April, 2005.

conclusion of the court that the plaintiff must have failed to properly store his bankcard and password, since according to the verification of the police, “Li Jianguo” took the money with the real bankcard and password of the depositor. As the plaintiff was also found at fault for the damage, the bank was ordered to only compensate the plaintiff part of his losses. The SPC upheld the decision.

(4) Duty to Mitigate Loss. Under Chinese contract law, the aggrieved party has the duty to mitigate any loss. If it has suffered further loss due to its failure to take appropriate measures, it is barred from claiming compensation for such losses from the breaching party. Any reasonable expense incurred by the aggrieved party in preventing further loss is to be borne by the breaching party. This rule is also adopted by Article 7.4.8 PICC. 25

In the case of *Meng Yuan v Zhongjia Travel Agency*,¹⁰⁶ the plaintiff and the other five persons entered into a travel contract with the defendant on 21st April, 2003 and paid the total fees to the defendant for all six persons. The defendant booked flight tickets and hotel rooms for this touring group on 22nd April, 2003. The contract stipulated that the flight tickets were group tickets and may not be rescheduled or refunded. On 24th April, 2003, the plaintiff orally requested the defendant to cancel the trip and to refund the fees on the grounds that a SARS pandemic had broken out in several provinces of China. The defendant suggested a transfer of the flights and hotel rooms for these six persons, but refused to refund the total payment. However, the plaintiff neither provided the names of the five persons nor did she authorise the agency to transfer the flight tickets. The plaintiff asserted that she had given notice of a termination of contract on 24th April, 2003, but the defendant did not take the appropriate measures to prevent the occurrence and increase of the loss. The court ruled that the plaintiff was not entitled to terminate the contract because the scope of SARS at that time had hardly any impact on human health. Furthermore, the plaintiff and the defendant had not reached an agreement on the termination. The court reasoned that when one party proposed to terminate the contract, the other party has the duty to take appropriate measures in order to prevent further loss. It is barred from recovering damages for such further loss in cases of a failure to take appropriate measures. However, in this case the flight tickets were group tickets and neither they nor the hotel rooms could be refunded. The defendant had proposed to 26

¹⁰⁶ *Meng Yuan v Zhongjia Travel Agency* (孟元诉中佳旅行社旅游合同纠纷案), judgement of the Beijing First Intermediate People's Court dated 20th November, 2004.

transfer the flight tickets to another party, but the plaintiff refused to cooperate with the defendant. Under these circumstances, it would be unreasonable to require the defendant to mitigate the loss; thus, the plaintiff herself should bear the whole loss.

- 27** (5) Counterbalance of Loss and Profit. If in a particular circumstance the innocent party is able to benefit from the breach, the damages to be paid by the non-performing party will be offset by the profit accrued from the breach. Although this principle is not clearly stipulated in Chinese contract law, in practice, it has been widely recognized.¹⁰⁷ In the Judicial Interpretation on Sales Contracts, the SPC has explicitly acknowledged this rule.¹⁰⁸

b. Calculation of Lost Profit

- 28** According to the principle of full compensation, the amount of damages payable should equal the other party's loss from the breach, including lost profit. The calculation of the amount of lost profit is a complex process. The court has to either apply the method agreed upon by the parties or, in the absence of such an agreement, adhere to the following rule: In case of an equipment or material sales contract, lost profit usually refers to the loss of production profit. In cases of a contract of hired works, lost profit usually refers to the loss of business operations profit. In cases of a sequence of sales contracts, the lost profit usually refers to the loss of resale profit.¹⁰⁹ The calculation of the loss profit is also subject to the aforementioned rule of foreseeability, rule of contributory culpability, rule of duty to mitigate loss, and rule of counterbalance of loss and profit.
- 29** The innocent party bears the burden of proof in regards to the total amount of loss of benefits and the necessary transaction costs. The breaching party is obligated to prove the fact that the innocent party failed to take reasonable mitigating measures or the innocent party has benefited from the breach of contract or the innocent party was also at fault.¹¹⁰

¹⁰⁷ Art. 10 of the Opinions on Trials under the Current Situation; *WANG Liming* (2003), 663; *HAN Shiyuan* (2004), 759.

¹⁰⁸ Art. 31 of the Interpretations of Trials of Purchase and Sales Contracts.

¹⁰⁹ Art. 9 of the Opinions on Trials under the Current Situation; *WANG Chuang* (2009), 3-8; *LI Guohui*, 10-13.

¹¹⁰ Art. 11 of the Opinions on Trials under the Current Situation; *WANG Chuang* (2009), 3-8; *LI Guohui*, 10-13.

Art. 122 CL states that if one party's non-performance has harmed the personal interests of the other party, the aggrieved party will be entitled to hold the party liable for the breach of contract. Therefore, personal interests are included in the scope of contractual damages. Nevertheless, the scope of damages is subject to the rule of foreseeability. Consequently, whether or not damage in personal interests is actionable in contract depends on whether the defaulting party could have foreseen this kind of harm at the time of concluding of the contract. **30**

With respect to mental distress, the CL does not expressly address this issue. In the past, most commentators used to believe that this type of harm is not actionable in contract. The main reason is that contractual liability and tort liability have different functions. Mental loss is usually beyond the foreseeability of the defaulting party and is hard to be measured in monetary terms.¹¹¹ However, increasingly more scholars have turned to support the viewpoint that mental loss should be included in the scope of contractual remedies.¹¹² Case law is inconsistent in this respect.¹¹³ Even for the same type of contract, different district courts hold different opinions. In the case of *Zhu Hang v Changkuo Taxi Company & Fu Jianqi*, the taxi driver had abandoned the passenger who had suffered an epileptic attack on the side of the road. The district court ruled that the defendants should compensate for the mental damage of the plaintiff.¹¹⁴ On the contrary, in the case of *Zhang v Bus Company Second Branch*, the passenger was hurt when the bus suddenly hit the brakes, but the court did not back the plaintiff's claim for mental loss.¹¹⁵ **31**

Mental loss is usually actionable in a suit of tort. However, contract relief does not contradict tort liability. Art. 122 CL has recognized the concurrence of contractual liability and tort liability. There is a view holding that mental injury is excluded from **32**

¹¹¹ WANG Liming (1996), 400.

¹¹² HAN Shiyuan (1998), 27-30; CHENG Xiao, 105; NING Hongli, 55; LI Yongjun, 60-62.

¹¹³ In the case of *Xiao Qing and Liu Hua Wei v Xu Guang Enlarged Printing Service*, the court upheld the claim to damages for mental injury, Institute of Applied Legal Studies of the Supreme People's Court (最高人民法院应用法学研究所), Selected Cases of the People's Court (人民法院案例选) 1995, No. 1, 74-78; *Li Hai Jian v Yang Cheng Tourism Service*, in this case the court denied the claim to damages for mental injury, Institute of Applied Legal Studies of the Supreme People's Court (最高人民法院应用法学研究所), Selected Cases of the People's Court, Special to Civil Cases of 1992-1996 (人民法院案例选(1992-1996 民事卷)), 2000, 618-624.

¹¹⁴ *Zhuhang v Changkuo Taxi Company and Fu Jianqi* (朱杭诉长阔出租汽车公司、付建启赔偿纠纷案), judgement of the People's Court of Chaoyang District in Beijing dated 18th August, 2004.

¹¹⁵ Qi YingYang/Wu Hong, 195-202.

contractual remedy and may only be recovered by claiming tort liability, pursuant to art. 122 CL. The main argument is that if the non-defaulting party could claim all losses, including mental loss, through an action in contract, the article would not need to stipulate that the party may resort to tort relief.¹¹⁶ However, the literal meaning of art. 122 CL only emphasizes that the aggrieved party can select one form of relief instead of expressly excluding mental loss from contract remedy. At most we can conclude that art. 122 CL does not clarify how to recover mental loss as it does not mention mental loss at all.

- 33** It is beyond doubt that a breach of contract is able to cause mental loss of the non-defaulting party under certain circumstances. In addition, mental loss is not naturally beyond the foreseeability of the defaulting party. It would be unfair to the victim if the court completely and uniformly refused to recognize mental loss. A reasonable solution to this problem may be to admit the actionability of mental loss in contract and to simultaneously impose restrictions on the remedy with regards to the foreseeability rule. Just like personal interest, only when mental loss is foreseeable by the non-performing party, can it be recovered through contract remedy.
- 34** However, in 2010, the SPC expressly denied the proposal of allowing the aggrieved party to recover mental damage in a travel contract. Art. 21 of the Interpretations of the SPC of Issues in Trials of Travel Disputes¹¹⁷ provides that if a tourist brings an action on the basis of a breach of contract and claims mental damages, the court must inform the plaintiff to amend the suit of contract to the suit of tort. Otherwise the court will dismiss the claim for mental loss in the suit of contract. Judges of the SPC insisted that damages for mental loss are unavailable in a suit of contract.¹¹⁸ It seems that in this case the SPC held the most conservative position on this issue.

d. Punitive Damages

- 35** As mentioned above, the purpose of damages is to recover the loss sustained by the aggrieved party. The aggrieved party is barred from being enriched by damages for a breach of contract. Therefore, Chinese contract law in principle does not admit punitive damages. There are, however, two exceptions:

¹¹⁶ WANG Liming (1996), 400.

¹¹⁷ 最高人民法院关于审理旅游纠纷案件适用法律若干问题的规定, promulgated on 26th October, 2010 and effective from 1st November, 2010.

¹¹⁸ ZHANG Jinxian/WANG Yuying, Suits for Travel Contracts may not Receive Mental Damages (旅游合同纠纷之诉不能获得精神损害赔偿), People's Court Daily (人民法院报), 29th February, 2012, 7.

(1) Consumer Contracts. Art. 49 of the Law on Protection of Consumer Rights **36** confers a consumer the right to claim up to double the amount of the price he paid for the goods purchased or service received if a business operator committed fraudulent activities in supplying the goods or service. In this case, the amount of punitive damages is limited to the price paid by the consumer.

(2) Contracts for the Sale of Commodity Housing. When the seller sells or **37** mortgages a premise to a third party after the conclusion of a sale of a commodity house and purchase contract, or the seller deliberately conceals key facts before the conclusion of the contract, rendering the contract void, revoked, or rescinded, then the buyer is entitled to recover the purchase price already paid with interest and compensation for the losses and to claim additional damages not to exceed the paid purchase price.¹¹⁹

4. Liquidated Damages

a. Permissibility

Contract parties may agree that if one party breaches the contract, then said party **38** will pay a certain sum of liquidated damages to the other party in light of the degree of breach, or come to an agreement on a method to calculate damages for the loss resulting from the party's breach. Courts generally honor such agreements, but are also allowed to adjust the amount of liquidated damages when it is excessively above or below the actual loss resulting from the breach. Where the parties agree upon liquidated damages for delayed performance, the breaching party still has to render performance, in addition to payment of the liquidated damages.¹²⁰

In the case of *Guangxi Guiguan Electric Power Co., Ltd. v Guangxi Yongchen Real* **39** *Estate Development Co., Ltd.*, the SPC ruled that in the case of rescission of the contract, the claim for liquidated damages ceases to exist since the contract is

¹¹⁹ Arts. 8 and 9 of the Interpretation of Commodity Premises. Key facts refer to circumstances such as where a vendor failed to obtain a permit from the proper authorities for the sale of commodity housing, the house sold has already been mortgaged, or the house being sold has already been sold to a third party or allocated as compensation for resettlement.

¹²⁰ Art. 114 CL.

deemed to have never existed.¹²¹ This opinion is contrary to mainstream academic view.¹²² According to the guiding opinion and the interpretation on sales contracts issued by the SPC, liquidated damages remain in effect even in the case of a rescission of a contract.¹²³

b. Adjustment to the Amount of Liquidated Damages

- 40** Liquidated damages have two aspects, a compensatory and a punitive one.¹²⁴ By its nature, the amount of liquidated damages may not exceed the amount of the actual loss caused by a default, as it is predefined already at the time of the conclusion of a contract. A court is allowed to increase the amount of liquidated damages up to the amount of actual losses. After such an increase is ordered, one party is no longer allowed to claim damages from the other party.¹²⁵
- 41** Conversely, if the amount of liquidated damages exceeds the actual losses by 30 percent, then the court should lower it.¹²⁶ In general, an adjustment to the amount of liquidated damages shall follow the principle of fairness and good faith and take factors such as the performance of the contract, the contracting status of the parties, the extent of fault of the parties and anticipated profits thereof, etc. into consideration.
- 42** The defaulting party bears the burden of proof regarding excessive liquidated damages, while the innocent party bears the burden to establish that the liquidated damages are reasonable, if it claims so.¹²⁷ In practice, the defaulting party must first discharge his duty of proof, after which the burden may then be shifted to the innocent party to demonstrate the reasonableness of the liquidated damages.

¹²¹ *Guangxi Guiguan Electric Power Co., Ltd. v Guangxi Yongchen Real Estate Development Co., Ltd.* (广西桂冠电力股份有限公司与广西泳臣房地产开发有限公司房屋买卖合同纠纷案), judgement of the SPC dated 15th December, 2009.

¹²² *WANG Liming*, 701; *HAN Shiyuan*, 788; *Cui Jianyuan*, 351.

¹²³ Art. 8 of the Opinions on Trials under the Current Situation; art. 26 of the Interpretation of Trials of Purchase and Sales Contracts.

¹²⁴ *WANG Chuang* (2009), 3-8.

¹²⁵ Art. 28 of the Interpretation of the CL (Part II).

¹²⁶ Art. 29 of the Interpretation of the CL (Part II).

¹²⁷ Art. 8 of the Opinions on Trials under the Current Situation.

5. Deposit

The parties may agree that one party gives a deposit to the other party as a **43** guarantee for the obligee's right in accordance with the Security Law¹²⁸. Upon performance by the obligor, the deposit should either be set off against the price or refunded to the obligor. If the party giving the deposit fails to perform its obligations under the contract, it will not be entitled to claim a refund of the deposit. When the party receiving the deposit fails to perform its obligations under the contract, it has the duty to return the other party twice the amount of the deposit.¹²⁹ In practice, if the parties agree upon a payment for both the liquidated damages and the deposit, in the case of breach by a party, the other party may elect to apply either the liquidated damages or the deposit clause.¹³⁰ It should be noted that there are various types of deposits. According to the purpose of deposits, a deposit can be classified as a deposit of security for entering into the contract, a deposit for a condition precedent to the formation or entry into effect of the contract, or a deposit for rescinding the contract, etc. Only the deposit for default cannot coexist with liquidated damages.

¹²⁸ 担保法, promulgated on 30th June 1995 and effective from 1st October 1995.

¹²⁹ Art. 115 CL.

¹³⁰ Art. 116 CL.

Chapter 8. Standard Form Contracts

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I. Overview

- 1 The widespread use of standard form contracts is no novelty in a modern economy. The efficiency of standard forms has greatly facilitated business negotiations and

the contract formation process. Their shortcoming is, however, also manifest. Business entities that have a more advantageous position in the transaction can easily impose into the contract unfair terms that prejudice the rights of the other parties, including, among others, the consumers.¹ Realizing this problem, Chinese lawmakers have provided rules in various Chinese laws, including the CL, to ensure fairness in standard form contracts.

Before the CL's enactment in 1999, standard form contracts were already regulated **2** by other Chinese laws.² When the CL was drafted, Chinese legislators decided to add more detailed and specific provisions regarding standard form contracts. Quite notably, instead of using the wording "standard form contracts" (格式合同), which had been adopted in previous Chinese legislations, drafters of the CL chose the phrase "standard terms" (格式条款). The use of this new phrase successfully enlarged the CL's scope of application regarding standard forms because it enables relevant provisions in the CL to become applicable not only to contracts exclusively based on standard forms, but also to relevant parts of those contracts containing both standard and non-standard terms. Consequently, the enlarged scope of application is favorable to the protection of consumer rights.³ In this chapter, however, the two phrases, namely "standard form contracts" and "standard terms" will be used interchangeably. They will both include contracts that only contain standard terms as well as the ones that contain both standard and non-standard terms.

II. Main Issues

1. Towards a More Accurate Definition

Pursuant to art. 39 para. 2 CL, standard terms are contractual terms that are drafted **3** by one party in advance for repeated use, and are not negotiated with the other party when the contract is concluded. Some scholars have pointed out a few inaccuracies in the CL's current definition of standard terms. Firstly, they propose that the part of the current definition that standard terms are drafted by one party to

¹ *Hu Kangsheng*, 70; *JIANG Ping*, 30.

² E.g., Art. 24 of the Law of Protection of Consumer Rights and Interests (消费者权益保护法), promulgated on 31st October, 1993 and effective from 1st January, 1994; last revision effective from 27th August, 2009.

³ *WANG Liming*, 3-4.

the contract should be interpreted broadly. According to them, standard terms may not necessarily be provided by one of the parties to the contract. They may be drafted by a third party but are nonetheless adopted by one party to the contract. As long as the terms are not to be negotiated with the other party, they should still qualify as standard terms.⁴ Chinese legislators seem to support this argument as well. They have also implied that as long as one party provides the standard terms, the definition is satisfied, even if that party did not personally draft those terms.⁵

- 4 Secondly, one opinion holds that standard terms do not have to be used repeatedly. It argues that repeated use is only the intended purpose when the standard terms were drafted. In practice, however, some standard terms are only used once, while some non-standard terms, freely negotiated between two parties, are used repeatedly. As a result, although most of the standard terms are indeed used more than once, terms that are only used once may also qualify as standard terms.⁶
- 5 Thirdly, some scholars argue that instead of being not “negotiated with the other party”, standard terms are terms that cannot be negotiated by the other party. Accordingly, the decisive character of standard terms is not whether the terms were negotiated between the parties, but whether they could be negotiated. In a standard form contract, the party that is provided with the standard terms may only take it or leave it. Their relatively weak position in business transactions as well as their lack of bargaining power does not leave any room for negotiation. On the other hand, however, if one party has the opportunity to negotiate certain terms in a contract, but nonetheless chooses to accept the terms without negotiation, even if those terms are not negotiated, they are not to be found as standard terms.⁷
- 6 Here, we think that emphasis should be put on the process in which certain terms are incorporated into the contract. If these terms are imposed by one party into the contract, while the other party, having no chance of negotiation, can only choose between accepting them and leaving them, then such terms should be considered standard terms. On the other hand, facts relating to who drafts the terms, whether the terms are intended for repeated use, and whether the terms are indeed negotiated, should not be decisive regarding the finding of standard terms.

4 CHEN Xiaojun, 46; BING Ling, 109.

5 HU Kangsheng, 70.

6 WANG Liming, 4.

7 CHEN Xiaojun, 47; WANG Liming, 4-5.

2. Model Contracts v Standard Form Contracts

In China, many government departments and trade associations promulgate model 7 contracts to the public as guidelines for parties to adopt in their commercial transactions.⁸ The purpose of these systematically drafted models is to perfect the contractual terms, clarify the parties' rights and obligations, and reduce potential disputes that may arise due to the parties' lack of legal knowledge and legal assistance.⁹ These model contracts, however, should be clearly distinguished from standard form contracts.

First of all, model contracts of this kind are not standard form contracts *per se*. This 8 is because the model contracts are usually provided for the parties only as reference. These models are by no means binding and the parties are free to change any term in them. Some terms in these model contracts are even deliberately left open, so that the parties may freely negotiate them. Therefore, the fact that the parties have the chance to negotiate the terms of model contracts clearly distinguishes them from standard form contracts.¹⁰

Albeit saying so, if one party abuses its advantageous position in the transaction 9 and forces the other party to accept a model contract, or a draft contract based on a model contract, then the resulting contract may be considered a standard form contract. Just as mentioned earlier, the fact that a third party drafts the contract, e.g. a government department or a trade association, instead of one of the parties, should not affect the finding of a standard form contract. A model contract can nonetheless form the basis of a standard form contract if a party provided with such a model is forced to accept it without having the chance to negotiate its terms.

3. Incorporation of Standard Terms into a Contract

When a contract contains both standard and non-standard terms, it may sometimes 10 be difficult to determine whether certain standard terms have been incorporated into the contract. For example, in a sales transaction, after a seller and a buyer negotiate the price, quantity, and quality of certain products, the seller sends the buyer a

⁸ BING Ling, 109.

⁹ GAO Yulan, 26.

¹⁰ Fu Jian, 131; WANG Liming, 5.

written confirmation containing sophisticated standard terms in the fine print. The seller then ships the product to the buyer and a few days later, the buyer accepts the products. In this sales transaction, does the purchase and sales contract contain only the negotiated terms, or are the standard terms also a part of the contract?

- 11** Although the CL does not, in its relevant part regarding standard terms, specify how standard terms may be incorporated into a contract, it is logical that relevant parts in the CL regarding contract formation become applicable to standard terms as well.¹¹ As a result, although the other party does not have the opportunity to freely negotiate the standard terms provided by the providing party, these standard terms will not automatically become a part of the contract. For these standard terms to be incorporated into the contract, the other party must manifest intent to accept them.¹²
- 12** Some scholars further argue that the providing party's obligation to notify, as provided in art. 39 CL, also applies to the incorporation of standard terms. In other words, if the providing party does not notify the other party of the standard terms in a reasonable manner, these standard terms will not become a part of the contract.¹³ According to this theory, the CL requires that the providing party carefully fulfill its obligation to notify the other party of all standard terms when concluding a standard form contract.

4. Inconsistency between art. 39 and art. 40?

- 13** According to art. 39 para. 1 CL, the party that provides the standard terms (the providing party) should define the parties' rights and obligations pursuant to the principle of fairness. The providing party should also, in a reasonable manner, notify the other party of the terms that exempt or limit the providing party's liability. If requested by the other party, the providing party should explain these terms.¹⁴
- 14** In a judicial interpretation, the SPC has elaborated on the providing party's obligation to notify. According to the SPC, the "reasonable manner" provided in art. 39, para. 1 CL requires that, when concluding a contract, the providing party should use special signs such as words, symbols, and fonts that would sufficiently attract

¹¹ *LIU Lu/GAO Shengping*, 72-73.

¹² *WANG Liming*, 6.

¹³ *LIU Lu/GAO Shengping*, 72; *WANG Liming*, 6-7.

¹⁴ Art. 39 para. 1 CL.

the other party's attention, for the contents in standard terms that exempt or limit the providing party's liability.¹⁵ The providing party also bears the burden of proof on the issue of whether the obligation to reasonably notify and explain has been fulfilled.¹⁶

Art. 40 CL has stipulated situations where standard terms are invalid. Firstly, a **15** standard term is invalid if it falls into the situations provided in art. 52 and art. 53 CL, according to which a contract or a clause will be found null and void in certain circumstances (*supra* Chapter 5 at 16 et seqq.). Secondly, a standard term is invalid if, within this term, the providing party exempts his own liability, imposes heavier liability on the other party, or precludes the other party's major rights. Although the CL does not specify what rights qualify as major rights, they should refer to the rights that are usually provided in a contract of the same kind or to the rights provided by law.¹⁷

The SPC also tries to supplement art. 40 CL. According to the SPC, when the **16** providing party violates its obligation to notify the other party of the standard terms or to explain them to the other party, as provided in art. 39 CL, which results in the other party's failure to notice the term that exempts or limits the providing party's liability, the other party may request a court to revoke this standard term.¹⁸

Many scholars think art. 39 and art. 40 CL are inconsistent with each other. In their **17** opinion, if a standard term is invalid when the providing party exempts his own liability (art. 40), then the providing party's obligation to notify the other party of such terms (art. 39) becomes redundant and useless. This is because even if the providing party notifies the other party of all the terms that exempt the providing party's liability and explain these terms to the other party, these standard terms are still invalid.¹⁹ Another scholar thinks the inconsistency is the result of a legislative error and that art. 40 should not include the phrase relating to exemption of liability.²⁰

Other scholars, however, do not think these two articles are inconsistent with each **18** other, but have offered different reasons to support their argument. One scholar

¹⁵ Art. 6 para. 1 of the Interpretation of the CL (Part II) (最高人民法院关于正确适用《中华人民共和国合同法》若干问题的解释(二)), promulgated on 24th April, 2009 and effective from 13th May, 2009 (hereinafter: Interpretation of the CL (Part II)).

¹⁶ Art. 6 para. 2 Interpretation of the CL(Part II).

¹⁷ JIANG Ping, 31.

¹⁸ Art. 9 Interpretation of the CL (Part II).

¹⁹ HU Zhichao, 19.

²⁰ LIANG Huixing, 28.

argues that the exemption of liability of which the providing party has to notify the other party, as required by art. 39 CL, refers to the providing party's liability that will arise under the contract in the future. However, the exemption of liability, as provided in art. 40 CL, refers to the current obligations which the providing party has to burden.²¹ Some other scholars think that art. 39 CL governs the formation of a contract, which means that if the providing party of a standard term fails to notify the other party of its content in a reasonable manner, the standard term will not become a part of the contract. Art. 40 CL, on the other hand, governs those standard terms that have already become a part of the contract. If any of these terms violates art. 40 CL, it will be found invalid.²²

- 19** The SPC has tried to solve the controversy through its judicial interpretation. According to the SPC, if the providing party violates its obligation under art. 39 CL and fails to notify the other party of any relevant standard terms, the other party may request the courts to revoke the standard terms.²³ The courts will also find a standard term invalid if the providing party violates art. 39 CL and one of the circumstances provided in art. 40 CL also exists.²⁴ These rules have, however, aroused even more criticism. Scholars think these rules are logically confusing and incompatible with the systems established by the CL.²⁵ Despite the criticism, in judicial practice, these rules formulated by the SPC should be given enough attention, because they form the authority, apart from the CL itself, for the courts to rely on in a certain case.

5. Battle of Forms

- 20** When two parties both try to use their own boilerplates to negotiate a contract, the “battle of forms” situation is likely to arise. The two parties may have appeared to reach a contract by agreeing on the essential terms in that contract, but their different boilerplates, or standard forms, which are usually drafted by their respective lawyers, may well contain contradicting terms. Under these

²¹ *WANG Liming*, 9.

²² *CHENG Jinhong*, 55.

²³ Art. 9 Interpretation of the CL (Part II).

²⁴ Art. 10 Interpretation of the CL (Part II).

²⁵ *WU Yiping*, 64; *ZHOU Qinglin*, 189-190.

circumstances, it becomes an important legal issue to ascertain whether the two parties have reached a contract and, if so, the exact terms of the contract.

Unfortunately, the CL does not contain any particular rule regarding the battle of forms situation. A contextual interpretation of the CL, however, may reach a conclusion similar to the “last shot principle” adopted by some other countries.²⁶ This is because, according to art. 30 CL, if the offeree makes a material change to the offer, then the qualified “acceptance” becomes a new offer.²⁷ In addition, the scope of changes that will be considered material is very broad under Article 30 of the CL. Any change regarding the contract’s subject matter, quantity, quality, price or payment, period of performance, place and way of performance, default liability, and dispute resolution method, will all be considered a material change to the offer.²⁸ As a result, suppose a buyer and a seller negotiate a deal and reach an agreement based upon the seller’s standard forms, but the buyer later sends a confirmation bearing its own standard forms, which contain different terms on any of the issues provided in art. 30 CL. Subsequently, if the two parties start performing without further negotiation, then, under the CL, the latest standard forms as sent out by the buyer would become the contract terms because the seller’s original version would be considered materially changed and, therefore, not accepted by the buyer.

Chinese scholars, however, propose that the CL should abandon the “last shot rule”,²² because this rule is too simple and primitive and may cause unfairness in practice.²⁹ They further propose that when dealing with a battle of forms situation, the CL should adopt the “knock out rule”. This means that the terms on which the parties’ different forms have agreed will become a part of the contract, while the terms on which the parties’ different forms do not agree will be “knocked out” of the contract, and other terms in the already formed contract will be supplemented by relevant provisions in the CL.³⁰

²⁶ *HU Li*, 46.

²⁷ Art. 30 CL.

²⁸ *Ibid.*

²⁹ *HU Li*, 46.

³⁰ *HU Li*, 46; *LI Xianbo/ZHONG Yuehui*, 100; *XUE Guorong/JIANG Haifeng*, 18.

6. Interpretation

- 23** The CL also lays down rules regarding ways to interpret standard terms. When there is a dispute concerning a standard term, the term should first be interpreted in accordance with its ordinary meaning. If there are two or more different ways to interpret a standard term, it is to be interpreted in the way that disfavors the providing party. If a standard term is inconsistent with a non-standard term, then the non-standard term prevails.³¹.

³¹ Art. 41 CL.

Chapter 9. Particular Types of Contracts

Literature: CHEN Xiaojun (陈小君) (ed.), *Contract Laws (合同法学)*, Beijing 2007. CUI Jianyuan (崔建远), *Four Arguments on Service Contracts (承揽合同四论)*, *Journal of Henan Administrative Institute of Politics and Law (河南省政法管理干部学院学报)* 2010, No. 2, 75-79. GUO Mingrui (郭明瑞) (ed.), *Contract Law Theories (合同法学)*, Shanghai 2005. HAN Shiyuan (韩世远), *Defects in Subject Matter of Lease Contracts and Contractual Remedies (租赁标的瑕疵与合同救济)*, *China Legal Science (中国法学)* 2011, No. 5, 57-69. HE Zhi (何志) (ed.), *Contract Law: Theoretical Essentials and A Practical Guide (合同法原理精要与实务指南)*, Beijing 2008. HU Kangsheng (胡康生) (ed.), *Interpretation of the Contract Law of the People's Republic of China (2. ed) (中华人民共和国合同法释义)*, Beijing 2009. JIA Linqing (贾林青)/TONG Bingjun (仝炳军), *Contract Law: Study of the Application of Relevant Rules Relating to the Burden of Risks of Accidents in Purchases and Sales Contracts (《合同法》有关买卖合同意外风险承担规则的适用研究)*, *Journal of Law Application (法律适用)* 2004, No. 9, 32-37. JIANG Ping (江平) (ed.), *A Detailed Explanation of the Contract Law of the People's Republic of China (中华人民共和国合同法精解)*, Beijing 1999. JIN Liangxin(金亮新)/WANG Weiping (汪卫平), *Analysis on the Right of Revocation in Gift Contracts (试析赠与合同中的撤销权)*, *Journal of Political Science and Law (政法论丛)* 1999, No. 5, 17-19. LI Guoguang (李国光) (ed.), *Interpretation and Application of Contract Law (合同法解释与适用)*, Beijing 1999. LI Zhiqinag (李志强), *The Inconformity and its Solution of the Gift Contracts System in China (论我国赠与合同体系之不协调性及其解决)*, *Legal Science Magazine (法学杂志)* 2009, No. 10, 120-122. SUN Yongquan (孙永全), *A Study on Issues Relating to Lease Contracts in Judicial Practice (租赁合同在审判实践中的问题研究)*, *Shandong Justice (山东审判)* 2005, No. 3, 33-34. SUN Zhiyuan (孙志远), *Commonly Seen Issues Regarding Service Contracts in Practice (承揽合同在实践中经常遇到的问题)*, *Shandong Justice (山东审判)* 2005, No. 3, 35-36. TANG Ming (唐明), *Legislative and Judicial Practice of Gift Contracts (试论赠与合同的立法及司法实践)*, *Chinese Legal Science (中国法学)* 1999, No. 5, 64-73. TONG Xinqiu (佟欣秋), *Differentiation and Analysis of the Natures of Service contracts and Sales Contracts (承揽合同与买卖合同的性质辨析)*, *Journal of Liaoning Normal University (Social Science Edition) (辽宁师范大学学报(社会科学版))* 2010, No. 3, 26-28. WANG Liming (王利明), *Comparison Between the Purchase and Sales Contracts Systems in China and Germany (中德买卖合同制度的比较)*, *Journal of Comparative Law (比较法研究)* 2001, No. 1, 21-37. WANG Wenjun (王文军), *Revocation of Gift Contracts by Free Will (论赠与合同的任意撤销)*, *Legal Forum (法学论坛)* 2010, No. 6, 142-147. XUE Wencheng (薛文成), *Several Issues Concerning Gift Contracts (关于赠与合同的几个问题)*, *Journal of Tsinghua University (Philosophy and Social Sciences) (清华大学学报(哲学社会科学版))* 1999, No. 4, 29-33. YANG Yongqing (杨永清), *The Risk of Loss in Purchase and Sales Contracts (买卖合同中的风险负担规则)*, *People's Judicature (人民司法)* 1999, No. 8, 4-6. ZHANG Shaoying (张少瀛)/KAN

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I. Background

- 1 Apart from setting out general provisions on all kinds of contracts, the CL, in its section on specific provisions, contains detailed provisions regarding 15 particular types of contracts. The most commonly seen contracts include purchase and sales contracts (买卖合同), contracts for the supply and consumption of electricity, water, gas or heat (供用电、水、气、热力合同), gift contracts (赠与合同)¹, loan contracts (借款合同), lease contracts (租赁合同), financial lease contracts (融资租赁合同), service contracts (承揽合同)², construction project contracts (建设工程合同), carriage contracts (运输合同), technology contracts (技术合同), safekeeping contracts (保管合同)³, warehousing contracts (仓储合同), entrustment contracts (委托合同), brokerage contracts (行纪合同), and intermediation contracts (居间合同). In legal academia and practice, these 15 types of contracts are usually referred to as the “named contracts” (有名合同), while contracts not specifically mentioned in the CL are usually referred to as the “unnamed contracts” (无名合同).⁴ This chapter will only focus on four commonly seen contracts, namely, purchase and sales contracts, gift contracts, lease contracts, and service contracts.
- 2 For the named contracts, while relevant rules in the specific provisions apply in priority, rules in the general provisions remain directive and applicable.⁵ For the unnamed contracts, on the other hand, because there are no particular rules formulated for them, general provisions of the CL apply and relevant provisions on the named contracts may be used as reference.⁶ Of course, the private nature of contract laws means that most of the rules in the CL are discretionary. As a result, the major function of the specific provisions of the CL is to work as gap-fillers.⁷

1 Translated as “donation contracts” in the official translation by the NPC.
2 Translated as “work contracts” in the official translation by the NPC.
3 Translated as “contracts of deposits” in the official translation by the NPC.
4 *HU Kangsheng*, 199.
5 *CHEN Xiaojun*, 235.
6 Art. 124 CL.
7 *CHEN Xiaojun*, 236.

II. Purchase and Sales Contracts

1. Overview

a. Definition

Among the different types of contracts provided in the section on specific provisions 3 of the CL, purchase and sales contracts have the most sophisticated provisions. Pursuant to art. 130 CL, a sales contract is a contract in which the seller transfers the ownership of goods to the buyer and the buyer pays the price of the goods to the seller.⁸ From this definition, it can be derived that the purpose of a sales contract is the act of exchange between goods and payments. This purpose distinguishes a sales contract from other types of contracts such as gift contracts.⁹

The above definition also indicates that the subject matter (标的物) of a sales 4 contract is goods. Some scholars construe this provision broadly to also cover rights.¹⁰ However, most scholars support a narrow interpretation of the law and argue that sales contracts under the CL are confined only to the sales of goods.¹¹ As per these scholars, based on the language of the CL and other relevant Chinese civil laws, goods in this provision include both movables and immovables (动产和不动产), but not rights. Moreover, most of the commonly seen transactions of rights have already been regulated by other parts of the CL, among other laws. For example, Chapter 5 CL contains special provisions on the transfer of debts. Rules relating to the transfer of intellectual properties (IP) can be found in corresponding IP-laws. As for transactions of securities and other negotiable instruments, there are also different PRC laws in place.¹² Chinese legislators also seem to support this narrow interpretation.¹³

The argument that the sales contracts provided in the CL do not apply to 5 agreements relating to the transfer of rights, however, by no means indicates that the CL is not applicable to these agreements on the whole. This is because the relevant provisions in the general provisions of the CL will still apply to agreements

⁸ Art. 130 CL.

⁹ CHEN Xiaojun, 238; GUO Mingrui, 254.

¹⁰ HE Zhi, 494.

¹¹ LI Guoguang, 619; JIANG Ping, 109; CHEN Xiaojun, 238; WANG Liming, 21-23.

¹² WANG Liming, 21-23.

¹³ HU Kangsheng, 204.

relating to the transfer of rights.¹⁴ At the same time, according to art. 174 CL, for contracts with payments (有偿合同) other than sales contracts, when there are no special rules provided in other laws, the relevant provisions regarding sales contracts in the CL will serve as reference.¹⁵ This provision is of course applicable to agreements relating to the transfer of rights.¹⁶

b. Major Rights and Obligations of Parties

- 6 The CL has provided a non-exclusive list of major rights and obligations for both the seller and the buyer in a sales contract. Both parties are expected to agree on more detailed and specific rights and obligations within their contract. Since the parties' rights and obligations under their contract are usually bilateral, which means the seller's rights are usually the buyer's obligations and *vice versa*, only the obligations of the parties will be discussed below.
- 7 The seller has two major obligations: (i) to deliver the goods, and (ii) to provide a defect warranty on the goods sold. It is the seller's most basic obligation to deliver (交付) the goods and transfer the ownership of the goods to the buyer.¹⁷ Furthermore, the CL requires the seller to provide a defect warranty (瑕疵担保) on the goods sold to the buyer. This defect warranty encompasses not only the warranty on the ownership of the goods (权利瑕疵), but also the warranty on the quality of the goods (质量瑕疵) (*infra* Chapter 7 at 16-18). The buyer also has two major obligations: (i) to pay, and (ii) to accept the goods. The buyer's primary obligation is to pay the price of the goods to the seller.¹⁸ When making a payment, the seller needs to do so in accordance with the contract in terms of method, time, location, and quantity of the payment. Furthermore, the buyer is under the obligation to accept the goods in accordance with the contract.

c. Arts. 61 and 62 CL

- 8 Arts. 61 and 62 CL serve as two gap-fillers in the CL. In the part regarding sales contracts, the CL frequently refers to arts. 61 and 62, which, in turn, offer rules to determine the outcome of important issues on which the parties in their sales

¹⁴ Hu Kangsheng, 204.

¹⁵ Art. 174 CL.

¹⁶ Hu Kangsheng, 204.

¹⁷ Guo Mingrui, 257.

¹⁸ Jiang Ping, 106.

contract failed to reach a clear agreement.¹⁹ As a result, these two articles play a very important role when a sales contract needs to be interpreted.

Art. 61 provides that after a contract becomes valid, if the parties did not agree on, **9** or did not clearly agree on the quality of the goods, the price or payment, or the place of performance, then the parties may reach a supplementary agreement in these regards. If the parties cannot reach a supplementary agreement, the issues are to be determined by other relevant clauses in the contract or usual trade practices. Art. 62 further sets forth detailed rules regarding how to determine the quality of the goods, the price or payment, the place of performance, the time period of performance, the way of performance, and which party should burden the cost of performance.

2. Delivery

Pursuant to the CL, delivery of goods plays an essential role in a sales contract. **10** Absent the parties' specific agreement, the time and place of delivery may decide a handful of significant legal issues, including the transfer of ownership, the passing of risk, and the proper performance of contracts.

a. Forms of Delivery

Art. 135 CL explicitly provides for two forms of delivery in a sales contract, namely, **11** the delivery of the goods themselves or the delivery of the documents of title. The CL has also implicitly recognized a third form of delivery, namely, if the goods are already in the buyer's possession before the conclusion of the sales contract, the delivery will be considered completed when the contract becomes valid.²⁰ In this case, no separate act of delivery is required.

Chinese scholars have also recognized a fourth form of delivery, which takes place **12** when the seller and the buyer agree that the seller will retain possession of the goods after the sales contract is concluded.²¹ In this scenario, which is similar to the previously discussed third form of delivery, although no actual act of delivery is required, delivery is nonetheless considered completed when the contract becomes

¹⁹ E.g. art. 141 para. 2, 154, and 159-161 CL.

²⁰ Art. 140 CL.

²¹ CHEN Xiaojun, 242; GUO Mingrui, 258; JIANG Ping, 112; LI Guoguang, 643.

valid.²² Importantly, however, this fourth form of delivery usually requires a specific second agreement between the two parties, such as a lease contract, which will set forth an additional legal relationship, separate from the sales transaction.²³ This second agreement is usually the reason why the seller may continue to possess the goods.

- 13** Apart from the delivery of goods or the documents of title, the seller should deliver any additional related documents to the buyer.²⁴ These documents include, among others, insurance policies, warranty certificates, commercial invoices, VAT invoices, certificates of quality, certificates of inspection, certificates of origin, directions of use, packing slips, etc.²⁵ Due to the importance of these documents, especially in international trade, the CL has made the delivery of them a legal obligation.²⁶
- 14** When the subject matter of a sales contract is also available in electronic form so that it does not need to be delivered as a tangible product, and the parties have not clearly agreed on the form of delivery, nor could such a form be ascertained pursuant to art. 61 CL, then the delivery is considered completed when the buyer receives the product or its documents of title.²⁷

b. Time of Delivery

- 15** The parties may agree on the time of delivery. If they have agreed on a period of time instead of a specific time, then the seller may deliver at any time within that period.²⁸ In the absence of a clear agreement, the time of delivery may be determined by other relevant clauses in the contract or usual trade practices.²⁹ If the time of delivery still cannot be determined, the seller may deliver at any time, and the buyer may request the seller to deliver at any time. There is, however, a necessary time for preparation allotted to the other side.³⁰

²² *Guo Mingrui*, 258.

²³ *Guo Mingrui*, 258; *Li Guoguang*, 643.

²⁴ Art. 136 CL.

²⁵ Art. 7 Interpretation of the SPC of Issues concernin the Application of Law in Trials of Disputes over Purchase and Sales Contracts (最高人民法院关于审理买卖合同纠纷案件适用法律问题的解释), promulgated on 10th May, 2012 and effective from 1st July, 2012 (hereinafter: Interpretation of Trials of Purchase and Sales Contracts).

²⁶ *HU Kangsheng*, 216; *JIANG Ping*, 114-115.

²⁷ Art. 5 of the Interpretation of Trials of Purchase and Sales Contracts.

²⁸ Art. 138 CL.

²⁹ Art. 61 and 139 CL.

³⁰ Art. 62 No. 4 and 139 CL.

As mentioned above, if the goods are already in the buyer's possession before the conclusion of the sales contract, then the time of delivery will be the time when the contract becomes valid.³¹

c. Place of Delivery

Similar to its provisions regarding the time of delivery, art. 141 para. 1 CL also allows the parties to freely agree on the place of delivery. In the absence of a clear agreement, the following rules are applied to determine the place of delivery:

(i) If the goods need to be transported to the buyer, the place of delivery is the place where the seller delivers the goods to the first carrier.³² Here, a carrier is someone who is independent from the two parties of the sales contract.³³ And the term “first carrier” indicates that if two or more carriers are engaged in the transportation process, the delivery occurs when the first carrier takes over the goods from the seller.³⁴ If, however, according to the contract, the seller needs to transport the goods on his own, then the place of delivery is the place where the goods are actually delivered to the buyer.³⁵ (ii) If the goods do not need to be transported to the buyer and both parties knew the location of the goods when concluding the contract, then the seller should deliver the goods at that location.³⁶ (iii) If the goods do not need to be transported to the buyer, but the two parties did not know the location of the goods when concluding the contract, then the seller should deliver the goods at his place of business, which was operating when the contract was concluded.³⁷

It should be noted that the rules provided in art. 141 CL to determine the place of delivery in a sales contract are not entirely the same as the general rule used to determine places of performance in contracts, which is provided in art. 62 CL and in art. 88 GPCL. It can be understood that the rules provided in art. 141 CL regarding the place of delivery are special rules that are to be applied in priority in the context of a sales contract.³⁸

³¹ Art. 140 CL.
³² Art. 141 para. 2 No. 1 CL.
³³ Art. 11 of Interpretation of Trials of Purchase and Sales Contracts.
³⁴ *Hu Kangsheng*, 222.
³⁵ *Hu Kangsheng*, 222; *Li Guoguang*, 666.
³⁶ Art. 141 para. 2 No. 2 CL.
³⁷ Art. 141 para. 2 No. 2 CL.
³⁸ *JIANG Ping*, 117.

d. Excessive Delivery

- 20** According to art. 162 CL, if the seller delivers more goods than the contract requires, the buyer has the right to either accept or reject the excessive amount. If the buyer decides to accept the excessive amount, he should pay for them according to the price agreed upon in the contract instead of the market price at the time of delivery.³⁹ As a result, it is reasonable to anticipate that the buyer will base his decision whether to accept or reject the extra goods on the difference in the contract price of the goods and the market price of the goods at the time of delivery. The CL wants to protect the buyer's interest by discouraging the seller from deliberately delivering excessive goods because of changes in market price.⁴⁰
- 21** If, however, the buyer decides to reject the excessive amount, he should notify the buyer in a timely manner.⁴¹ After giving such a notification, the buyer may keep the extra goods on the seller's behalf and claim any reasonable costs incurred during the period of storage.⁴² If the extra goods have caused any loss to the buyer, then the buyer may also require the seller to compensate him as long as the loss was not caused by the buyer's intentional acts or serious negligence.⁴³

3. Payment of Price

a. Amount of Payment

- 22** The amount that a buyer needs to pay a seller should, above all, be determined by the sales contract. In most sales contracts, the parties will explicitly agree on the price of the goods. Absent a clear agreement on such price arts. 61 and 62 will fill in the gap. In particular, if the price still cannot be determined by referring to other relevant clauses in the contract or usual trade practices, then the contract is to be performed on the basis of the market price at the location where the contract was performed and at the time when the contract was concluded.⁴⁴

³⁹ Art. 162 CL; *Jiang Ping*, 132; *Hu Kangsheng*, 245.

⁴⁰ *JIANG Ping*, 114.

⁴¹ Art. 162 CL.

⁴² Art. 6 para. 1 of the Interpretation of Trials of Purchase and Sales Contracts.

⁴³ Art. 6 para. 2 of the Interpretation of Trials of Purchase and Sales Contracts.

⁴⁴ Art. 62 No. 2 CL.

b. Place of Payment

The place of payment is normally either the place agreed upon in the contract or, if **23** the parties did not specifically agree on such place and no such time could be ascertained by other relevant clauses in the contract or usual trade practices, the seller's place of business. Where a payment is conditional upon the delivery of goods or the document of title, the payment is to be made at the place where the goods or the document of title is delivered.⁴⁵

c. Time of Payment

Similar to the place of payment, the time of payment is normally agreed upon in a **24** sales contract. If the parties did not specifically agree on such time and no such time could be ascertained by other relevant clauses in the contract or usual trade practices, then the buyer should make the payment at the same time he receives either the goods or the document of title.⁴⁶

4. Transfer of Ownership

As one of the most important articles in the CL's chapter regarding sales contracts, **25** art. 133 provides for the transfer of ownership in a sales contract.⁴⁷ According to this provision, the ownership of goods in a sales contract is transferred at the time of delivery, unless otherwise provided by law or agreed upon by the parties concerned.⁴⁸ The CL's provision is, in fact, the same as the provision in art. 72 GPCL. When the CL was drafted, Chinese legislators compared the different approaches adopted by other major countries and in relevant international conventions. In the end, however, they decided to follow the then-existing provision in the GPCL because of two main reasons: (i) the then-existing rule had proven successful in practice, and (ii) keeping the rule would make the law stable.⁴⁹ According to the CL, if the parties have specifically agreed on the transfer of **26** ownership, then such an agreement is to be enforced, unless it conflicts with

⁴⁵ Art. 160 CL.

⁴⁶ Art. 161 CL.

⁴⁷ *Hu Kangsheng*, 208.

⁴⁸ Art. 133 CL.

⁴⁹ *Hu Kangsheng*, 207-212.

another mandatory Chinese law.⁵⁰ This means that if there is any other law that has a specific and mandatory provision on the transfer of ownership, then such a law prevails.⁵¹ For example, the Real Rights Law (RRL) provides that the transfer of ownership of real properties is valid only after the point of registration.⁵² Pursuant to this provision, the ownership of a real property in a real property sales contract is transferred only after registration, instead of upon delivery. If, however, the parties have not specifically agreed on the transfer of ownership, and there is no other relevant law that sets forth a different rule, then the ownership of the goods in a sales contract is to be transferred from the seller to the buyer at the time of delivery.⁵³

- 27** It needs to be mentioned that for the sale of goods that bear IP rights, e.g. computer software, unless otherwise provided by law or agreed upon by the parties, IP rights do not transfer to the buyer even if the ownership of the goods has been transferred upon delivery.⁵⁴ Usually under Chinese law, IP rights based on a subject matter is detached from the sales transaction of the subject matter itself and needs to be traded separately if the parties wish to do so.⁵⁵

5. Passing on the Risk of Loss

- 28** The risk of loss is an important legal issue in a sales contract. It decides which party bears the burden for the loss of goods in cases of accidents.

a. General Rule

- 29** As a general rule, art. 142 CL provides that the risk of loss of goods passes from the seller to the buyer upon delivery, unless otherwise provided by law or agreed upon by the parties. In the process of drafting the CL, Chinese legislators compared different approaches adopted by other jurisdictions. Among them, the two most viable options included: (i) the risk of loss passing together with the transfer of ownership, and (ii) the risk of loss passing upon delivery. Chinese legislators adopted the second option out of practical concerns. As compared with ownership,

⁵⁰ Art. 133 CL; *Hu Kangsheng*, 208-209; *Jiang Ping*, 112.

⁵¹ *Hu Kangsheng*, 208-209; *JIANG Ping*, 112.

⁵² Art. 9 RRL.

⁵³ For a detailed discussion of relevant issues, see Part IV of this book.

⁵⁴ Art. 137 CL.

⁵⁵ *Hu Kangsheng*, 217; *JIANG Ping*, 115.

the risk of loss has a more practical effect on the interests of the parties involved. This is because, in practice, the transfer of ownership is usually abstract and sometimes vague. In contrast, delivery, as a factual issue, is relatively clear. Therefore, having delivery as the standard may help to identify which party bears the risk of loss much more clearly.⁵⁶ Most Chinese scholars agree with the approach adopted in the CL. They also believe that, in comparison with ownership, delivery is a more proper criterion to determine which party bears the risk of loss in a sales contract.⁵⁷

It should be pointed out that although as per the CL, both ownership and the risk of 30 loss transfer or pass upon delivery in principle, it does not mean they always transfer or pass at the same time. This is because the parties may specifically agree upon, or a law may specifically provide for, one of the two issues, but not the other. In this situation, either ownership or the risk of loss transfers or passes on to the buyer in accordance with the specific agreement between the parties or a specific provision in a law. However, the other will still transfer or pass upon delivery.

b. Specific Rules

Besides the general rule that the risk of loss passes upon delivery, the CL also 31 provides a number of specific rules to be applied in certain circumstances. In these circumstances, these rules shall take priority over the general rule.⁵⁸

(1) Goods That Need Transportation. Pursuant to art. 145 CL, unless otherwise 32 agreed upon by the parties, if the goods need to be transported to the buyer, the risk of loss passes to the buyer when the seller delivers the goods to the first carrier. Here, a carrier is someone who is independent from the two parties of the sales contract.⁵⁹ The term “first carrier” indicates that if more than one carrier is engaged in the transportation process, the risk of loss passes when the first carrier takes over possession of the goods from the seller.⁶⁰

According to art. 141 CL, when the seller is responsible for shipping the goods to the 33 buyer, delivery occurs when the seller hands the goods over to the first carrier.⁶¹ As a result, instead of an exception, this special rule under art. 145 CL is, in fact, a

⁵⁶ *Hu Kangsheng*, 223-224.
⁵⁷ *CHEN Xiaojun*, 250; *LI Guoguang*, 668-675; *YANG Yongqing*, 5.
⁵⁸ Art. 142 CL; *Hu Kangsheng*, 224.
⁵⁹ Art. 11 of the Interpretation of Trials of Purchase and Sales Contracts.
⁶⁰ *JIANG Ping*, 119.
⁶¹ Art. 141 para. 2 No. 1 CL.

logical deduction of the general rule under art. 142 CL, i.e. the risk of loss passes upon delivery.⁶²

- 34** It should be noted that this rule only applies when the seller is responsible for shipping the goods directly to the buyer.⁶³ Where the parties have agreed that the seller will transport the goods to a place designated by the buyer, but the seller instead delivers the goods to a carrier, the risk of loss is still borne by the seller until delivery occurs at the location designated.⁶⁴ Furthermore, if the parties have agreed that the buyer will collect the goods at the seller's place or at the place of a third party, then the risk of loss will not pass to the buyer until the goods are in fact delivered to the buyer.⁶⁵
- 35** (2) Goods in Transit. If the seller sells goods, which are already in transit when the contract is being concluded, unless otherwise agreed upon by the parties, the risk of loss will pass to the buyer when the sales contract is concluded.⁶⁶ However, if at the time of when the sales contract was concluded, the seller knew or should have known that the goods had already been damaged or lost, but did not disclose this fact to the buyer, then the seller should bear the risk of loss.⁶⁷
- 36** (3) In Cases of a Breach of Contract. Under the CL, a breach of contract will affect the passing of risk. The general rule for the passing of risk does not usually apply when a breach of contract occurs and the breaching party will usually bear the risk of loss. For example, if the quality of the goods does not meet the requirement of the contract to the effect that the purpose of the contract cannot be fulfilled, the buyer may reject the goods or rescind the contract (解除合同). If the buyer rejects the goods or rescinds the contract, the risk of loss is borne by the seller.⁶⁸
- 37** Similarly, the buyer also bears the risk of loss when he breaches the contract. If the goods cannot be delivered at the time agreed in the contract because of the buyer, the risk passes to the buyer at the time when he breaches the contract.⁶⁹ Also, if the seller places the goods at a certain place as per the contract, but the buyer fails to take the goods over, then the risk passes to the buyer at the time when he breaches

⁶² *Hu Kangsheng*, 227; *JIANG Ping*, 119.

⁶³ Art. 11 of the Interpretation of Trials of Purchase and Sales Contracts.

⁶⁴ Art. 12 of the Interpretation of Trials of Purchase and Sales Contracts.

⁶⁵ *Li Guoguang*, 684.

⁶⁶ Art. 144 CL.

⁶⁷ Art. 13 of the Interpretation of Trials of Purchase and Sales Contracts.

⁶⁸ Art. 148 CL.

⁶⁹ Art. 143 CL.

the contract.⁷⁰ Some scholars view the CL's rules as incomplete such as in the scenario where the buyer fails to take over the goods. They have proposed that the CL should clearly stipulate that the seller should notify the buyer once he places the goods at a certain location; otherwise, the risk should not pass to the buyer.⁷¹ Under the CL, the risk of loss passing to the buyer does not always mean the buyer 38 will suffer a loss in the end. Even if the risk of loss has passed to the buyer, the buyer still has the right to file a claim against the seller for any losses if the seller's performance did not meet the requirement of the contract.⁷²

(4) Fungible Goods. Absent any specific agreement between the parties, the risk of 39 loss of fungible goods in bulk does not pass to the buyer until the lost or damaged goods have been clearly appropriated under the sales contract by issued shipping documents, markings, or notifications.⁷³

6. Defect Warranty

The CL requires that the seller ensure the goods are free from any physical or legal 40 defects. Unlike many other national laws, the CL does not distinguish liabilities in a defect warranty from general liabilities in breaches of contracts,⁷⁴ as mentioned above (*supra* Chapter 7 at 16-18). Some scholars have proposed that the CL should also establish an independent liability system for defect warranties, because, from a theoretical perspective, such liabilities are different from default liabilities.⁷⁵ But other scholars prefer the CL's current framework, which includes defect warranty liabilities in the general default liability system. They think a separate defect warranty liability system is unnecessary under the CL, and a unified system may better protect buyers' interests.⁷⁶

a. Warranty on Ownership

According to the CL, the seller in a sales contract has the obligation to ensure that 41 no third party will claim any right on the goods the seller delivers to the buyer, unless

⁷⁰ Art. 146 CL.
⁷¹ JIA Linqing/TONG Bingjun, 37.
⁷² Art. 149 CL.
⁷³ Art. 14 of the Interpretation of Trials of Purchase and Sales Contracts.
⁷⁴ WANG Liming, 25-26; GUO Mingrui, 260.
⁷⁵ ZHANG Wei, 115.
⁷⁶ WANG Liming, 26-27.

the buyer knew, or should have known that a third party had such a right when the contract was concluded.⁷⁷

- 42** To be more exact, the seller needs to ensure that: (i) the seller is the legal owner of the goods, or the seller has the legal authority to dispose of (处分) the goods; (ii) the goods should be free of any security, including mortgage, pledge, or lien; and (iii) the goods do not infringe on any IP rights held by other entities.⁷⁸ If, however, the buyer knew or should have known about the defects on ownership before the contract was concluded, but was still willing to buy the goods, then the seller is not liable.⁷⁹
- 43** The CL also provides a remedy for the buyer who has discovered possible claims on the goods when the contract is being performed. If the buyer has sufficient evidence that a third party may claim rights on the goods against him, then the buyer may suspend paying the relevant price, unless the seller provides security to the buyer.⁸⁰

b. Warranty on Quality

- 44** The CL requires that the seller deliver goods that conform to the quality as agreed upon in the contract.⁸¹ The goods need to conform to the quality as described by the seller⁸² or to both the quality of the sample and the description given by the seller.⁸³ When the quality of the sample is different from the description and the parties cannot reach an agreement after a dispute arises, if the quality of the sample has not changed, then the court will rely on the sample's quality. However, if the sample's quality has changed, then the court will rely on the description.⁸⁴ If, however, the buyer did not know the sample had hidden defects, then the goods delivered still need to conform to the standard quality of the same goods, even if the goods delivered are identical to the sample.⁸⁵
- 45** Absent a clear agreement on the quality of goods, arts. 61 and 62 CL may fill in the gaps.⁸⁶ A supplementary agreement between the parties, or other relevant clauses

⁷⁷ Arts. 150 and 151 CL.

⁷⁸ *Hu Kangsheng*, 230-231; *JIANG Ping*, 123.

⁷⁹ *Hu Kangsheng*, 232; *JIANG Ping*, 124.

⁸⁰ Art. 152 CL.

⁸¹ Art. 153 CL.

⁸² Art. 153 CL.

⁸³ Art. 168 CL.

⁸⁴ Art. 40 of the Interpretation of Trials of Purchase and Sales Contracts.

⁸⁵ Art. 169 CL.

⁸⁶ Art. 154 CL.

in the contract or usual trade practices may help determine the quality of the goods.⁸⁷ If the quality of the goods can still not be determined by these factors, then the goods delivered should conform to national standards (国家标准) and trade standards (行业标准). In absence of such standards, the goods delivered should conform to the usual standard or the specific standard that fits the purpose of the contract.⁸⁸

The delivery of a defective product constitutes a breach of contract.⁸⁹ However, the seller will not be liable if the buyer knew or should have known about the defects of the goods at the time when the contract was concluded. Even if the buyer did know or should have known about the defects when the contract was concluded, the seller will nonetheless be liable if the buyer did not know at the time when the contract was concluded that such a defect would cause a notable reduction in the goods' basic utility.⁹⁰ The parties may, in their contract, reduce the seller's liability on defects or exempt the seller from such liability. However, such an arrangement is void if the seller did not disclose the goods' defects to the buyer intentionally or by serious negligence.⁹¹

c. Inspection

Inspection is another important issue relating to the quality of the goods in a sales contract. After taking over the goods, the buyer should inspect the goods within the agreed inspection period.⁹² The buyer should also notify the seller of any inconformity of the goods in terms of either quantity or quality within the agreed inspection period. If the buyer fails to give a timely notification, the goods should be deemed as conforming with the contract.⁹³

If the parties did not agree on an inspection period in the contract, then the buyer should inspect the goods in a timely fashion.⁹⁴ The buyer should also notify the seller of any inconformity of the goods in terms of either quantity or quality within a

87 Art. 61 CL.
88 Art. 62 No. 1 CL.
89 Art. 155 CL.
90 Art. 33 of the Interpretation of Trials of Purchase and Sales Contracts.
91 Art. 32 of the Interpretation of Trials of Purchase and Sales Contracts.
92 Art. 157 CL.
93 Art. 158 para. 1 CL.
94 Art. 157 CL.

reasonable time.⁹⁵ If the buyer fails to give a timely notification, or two years have passed since the buyer took over the goods, the goods should be deemed as conforming with the contract.⁹⁶ Where the seller gave an express warranty on the quality of the goods for a certain period of time, such a period, rather than the two-year period, would apply.⁹⁷ However, if the seller knew or should have known that the goods he delivered do not conform to the requirement of the contract, the buyer would not be bound by any of the time periods described.⁹⁸

7. Rescission of a Sales Contract in Whole or in Part

- 49 The rescission of a contract has been discussed in detail in the earlier chapters. In the following paragraphs, some special situations relating to the rescission of a sales contract will be analyzed. Since there could be more than one subject matter in one sales contract, when one party rescinds a sales contract, or part of a sales contract, the effect of the rescission on those subject matters may vary.
- 50 Some sales contracts may contain two subject matters, one of which is the principal matter (主物), and the other is the accessory matter (从物). For example, in a sales contract of a lock and a key, the lock is the principal matter and the key is the accessory matter. According to the CL, if part of a contract relating to the principal matter is rescinded because the principal matter does not conform to the contract's requirement, the effect of the rescission will also cover the accessory matter in the contract. If, however, the part of the contract relating to the accessory matter is rescinded because the accessory matter does not conform to the contract's requirement, the effect of the rescission does not cover the principal matter.⁹⁹ As a result, in the above example, if the quality of the lock does not conform to the contract, the buyer may rescind the part of the contract relating to the sales of the lock. If the buyer does so, the part of the contract relating to the key will also be rescinded, even if the quality of the key conforms to the contract. If only the quality of the key does not conform to the contract, but the quality of the lock does conform, then the buyer may rescind the part of the contract relating to the sales of the key, but the part of the contract regarding the sales of the lock would remain valid.

⁹⁵ *Ibid.*

⁹⁶ Art. 158 para. 2 CL.

⁹⁷ *Ibid.*

⁹⁸ Art. 158 para. 3 CL.

⁹⁹ Art. 164 CL.

Some other sales contracts have more than one subject matter, which are 51 independent from each other. If the quality of one subject matter does not conform to the contract, the buyer may rescind the part of the contract relating to this subject matter only. If, however, the separation of this subject matter from the others will cause a significant reduction in the value of all the subject matters as a whole, then the buyer may rescind the contract for all subject matters.¹⁰⁰

In a contract where the seller delivers the goods in multiple installments, if the seller 52 does not deliver one installment, or an installment delivered does not conform to the contract, so that this installment cannot fulfill the purpose of the contract, then the buyer may rescind the contract with respect to this installment.¹⁰¹ If the seller does not deliver one installment, or the installment delivered does not conform to the contract, so that this installment and the installments to be delivered later on cannot fulfill the purpose of the contract, then the buyer is entitled to rescind the contract with respect to this installment as well as the installments of future deliveries.¹⁰² When the buyer rescinds the contract with respect to one installment, if this and the other installments are interdependent, or the installments are non-severable from one another, the buyer may rescind the whole contract.¹⁰³

8. Special Types of Purchase and Sales Contracts

a. Payment by Installments

In a sales contract, the parties may agree that a payment be made in multiple 53 installments. This is especially common in sales of high value goods. In order to protect his own interest, the seller will usually require in the contract that, if the payment is late, he may demand full payment from the buyer or rescind the contract.¹⁰⁴ In order to protect the buyer from any unfair treatment, art. 167 CL requires that the seller can only demand that the buyer make full payment or rescind the whole contract, if the overdue payment equals at least one fifth of the whole contract price. Due to this mandatory provision, any part in a contract that violates

¹⁰⁰ Art. 165 CL.

¹⁰¹ Art. 166 para. 1 CL; *Hu Kangsheng*, 247-248.

¹⁰² Art. 166 para. 2 CL; *Hu Kangsheng*, 248.

¹⁰³ Art. 166 para. 3 CL; *Hu Kangsheng*, 248.

¹⁰⁴ *Hu Kangsheng*, 249.

this provision and prejudices the buyer's interest is void.¹⁰⁵ It should be made clear, however, that this mandatory provision does not prohibit the parties to a contract from agreeing to a more preferential treatment for the buyer. For example, the parties can agree that the seller will not demand full payment or rescind the contract unless the overdue payment equals one fourth of the whole contract price.¹⁰⁶

- 54** If the seller rescinds the contract because the buyer fails to make a payment in time, the seller is entitled to a usage fee for the goods and compensation for any loss sustained while the goods are in the buyer's possession.¹⁰⁷ Absent an agreement on the amount of the usage fee, Chinese courts will use the rental cost of the same goods at the same place as a reference.¹⁰⁸ Where the total payment the buyer has made to the seller exceeds the usage fee and the compensation, the seller should refund the excess balance to the buyer.¹⁰⁹

b. Trial Use

- 55** In some transactions, a seller may first allow a potential buyer to use a product for a period of time and then let the potential buyer decide whether to purchase the product. According to art. 170 CL the parties may agree on a period for trial use. Absent a clear agreement, and if no such period can be ascertained by relying on art. 61 CL, the seller is entitled to decide the length of the period. Within the trial use period, the potential buyer may decide whether or not to purchase the product. The potential buyer is presumed to be willing to purchase the product if he does not indicate otherwise at the end of the trial use period.¹¹⁰
- 56** There are a few other occasions where the potential buyer will be presumed to be willing to make the purchase. These occasions may include, for example, the buyer making a partial payment to the seller within the trial use period, or engaging in actions that do not fit the purpose of the trial use, such as selling, renting out, or setting up a mortgage on the product.¹¹¹ Moreover, a trial is usually free of charge, unless the parties explicitly agree otherwise in their contract.¹¹²

¹⁰⁵ Art. 38 para. 2 of the Interpretation of Trials of Purchase and Sales Contracts.

¹⁰⁶ *Hu Kangsheng*, 250.

¹⁰⁷ Art. 167 CL; Art. 39 para. 1 of the Interpretation of Trials of Purchase and Sales Contracts.

¹⁰⁸ Art. 39 para. 2 of the Interpretation of Trials of Purchase and Sales Contracts.

¹⁰⁹ Art. 39 para. 1 of the Interpretation of Trials of Purchase and Sales Contracts; *Hu Kangsheng*, 252.

¹¹⁰ Art. 171 CL.

¹¹¹ Art. 41 of the Interpretation of Trials of Purchase and Sales Contracts.

¹¹² Art. 43 of the Interpretation of Purchase and Sales Contracts.

Some purchase and sales transactions are conducted through bidding or auction. **57**
Because there are special Chinese laws and regulations in these regards,¹¹³ the parties' rights and obligations as well as relevant procedures in the biddings and auctions are governed by these special laws and regulations.¹¹⁴

III. Gift Contracts

1. Overview

A gift contract is a contract in which the promisor promises to give certain property **58**
(the gift) to the promisee for free, and the promisee acknowledges acceptance of the gift.¹¹⁵ Prior to the enactment of the CL, there was no legislation on gift contracts in China. The only authority concerning gift contracts was found in arts. 128–130 of the Opinions on the GPCL. This situation has been changed with the promulgation of the CL, which includes a chapter on gift contracts in its specific provisions.
Due to the specific characteristics of a gift contract, particularly its gratuitous nature, **59**
legal principles and provisions relating to gift contracts may be radically different from those applicable to other contracts, such as sales contracts. Although in some gift contracts there are certain obligations required of the promisee,¹¹⁶ these obligations do not constitute consideration in the contracts. As a result, obligations in gift contracts are usually unilateral.

2. Validity of a Gift Contract

Chinese legal scholars and practitioners have been in constant debate on the exact **60**
point in time when a gift contract should become valid. Some argue that it should be the time when the promisor actually delivers the gift to the promisee. In their opinion, the law should allow a promisor to regret and withhold the gift, because it is unfair to enforce a gratuitous promise. Others hold the opinion that a gift contract should become valid at the time of conclusion. According to the second opinion allowing a

¹¹³ The most important laws are the Auction Law (拍卖法), promulgated on 5th July, 1996 and effective from 1st January, 1997; and the Bidding Law (招标投标法), promulgated on 30th August, 1999 and effective from 1st January, 2000.

¹¹⁴ Art. 172-173 CL.

¹¹⁵ Art. 185 CL.

¹¹⁶ Art. 190 para. 1 CL.

promisor to regret works against the principle of good faith, especially if the promisee has already made certain preparations relying on the promise.¹¹⁷

- 61** Prior to the enactment of the CL, art. 128 of the Interpretation on the GPCL coincided with the first opinion.¹¹⁸ When the CL was being drafted, apart from the continuous debate between these two opinions, a third group of scholars and practitioners proposed that gifts contracts be divided into two categories: (i) oral gift contracts and (ii) written gift contracts. They further proposed that oral gift contracts should become valid at the time when the gift is delivered, and written gift contracts should become valid at the time of conclusion of the contract.¹¹⁹ In the end, the CL embraced the second opinion, no matter if the gift contract is in oral or written form. At the same time, taking the interests of the promisor into consideration, the CL gives the promisor a wide scope of rights to revoke the contract before he transfers the title of the gift to the promisee.¹²⁰

3. Promisor's Right to Revoke

a. Revoke by Free Will

- 62** Due to a gift contract's gratuitous nature art. 186 CL allows the promisor to regret his promise before he actually performs the contract.¹²¹ This means that the promisor may revoke the contract at any time before he transfers the title of the gift to the promisee.¹²² The legislators deliberately chose the wording "transfer the title of the gift" rather than "deliver the gift" because, under Chinese law, the ownership of some gifts, such as real properties, can only be transferred after completing the registration, although they may have been delivered to the buyer much earlier.¹²³
- 63** Under the CL, a promisor's right to revoke a gift contract by free will is restricted by one limitation. For gift contracts that are for the purpose of public interest or have a

¹¹⁷ *Hu Kangsheng*, 278-279.

¹¹⁸ Art. 128 Opinions of the SPC on Issues concerning the Implementation of the General Principles of Civil Law of the People's Republic of China (Trial) (最高人民法院关于贯彻执行《中华人民共和国民法通则》若干问题的意见(试行)), promulgated on and effective from 26th January, 1988; several articles abolished on 24th December, 2008.

¹¹⁹ *Hu Kangsheng*, 279.

¹²⁰ Art. 185-186 CL; *CHEN Xiaojun*, 266-268; *GUO Mingrui*, 288-289; *HU Kangsheng*, 279; *JIANG Ping*, 150; *TANG Ming*, 65; *XUE Wencheng*, 30. Some scholars, however, still support the second opinion despite the CL's provision. Cf. *LI Guoguang*, 904; *HE Zhi*, 609-610.

¹²¹ *Hu Kangsheng*, 280.

¹²² Art. 186 para. 1 CL.

¹²³ *Hu Kangsheng*, 281; *JIANG Ping*, 151.

characteristic of moral obligation, as well as gift contracts that have been notarized, the promisor does not enjoy the right to revoke by free will.¹²⁴ In the summer of 1998, one year prior to the CL's enactment, serious flooding disasters occurred in many places all over China. When humanitarian efforts were organized to raise money for the purpose of disaster relief, many enterprises declared that they would donate huge amounts of money to the people affected by the flooding. These enterprises received nationwide recognition for their philanthropic promise. Afterwards, however, some enterprises refused to fulfill their promise. Despite the whole nation's fury at such discreditable behavior, no legal enforcement was possible because, according to the then existing law, a gift contract only became valid after the gift was delivered. Although the CL provides that a gift contract becomes valid at the time of conclusion, because the promisor can freely revoke the contract at any time before he transfers the title of the gift, if no special provision were formulated, what happened in the summer of 1998 could very well be repeated. Therefore, in order to prevent the same situation from happening again, the CL chose to disallow the promisor's right to revoke by free will in a gift contract that is for the purpose of public interest or has a characteristic of moral obligation.¹²⁵ Similarly, with respect to a gift contract that has been notarized, it can be assumed **64** that the promisor has carefully considered his promise. Disallowing the promisor's right to revoke by free will in a notarized gift contract conforms to the principle of good faith and may serve to safeguard morality in the society.¹²⁶

b. Revoke by Law

The CL also allows the promisor to revoke a gift contract in the following **65** circumstances: (i) when the promisee severely infringes upon the promisor's rights or the rights of the promisor's close relatives; (ii) when the promisee has an obligation to support the promisor, but fails to perform his obligation; and (iii) when the promisee refuses to perform his obligations as agreed in the gift contract.¹²⁷ Different from the right to revoke by free will, there is no limitation on the promisor's **66** right to revoke by law. As long as one of the three listed occasions occurs, the promisor may revoke the gift contract, even if the title of the gift has already been

¹²⁴ Art. 186 para. 2 CL.
¹²⁵ *JIANG Ping*, 150-151; *JIN Liangxin/WANG Weiping*, 17; *TANG Ming*, 70.
¹²⁶ *HU Kangsheng*, 280.
¹²⁷ Art. 192 para. 1 CL.

transferred to the promisee, or even if the gift contract is for the purpose of public interest, has a characteristic of moral obligation, or has been notarized.¹²⁸ If, however, the promisee's illegal actions have caused the death of the promisor, or result in the promisor's loss of civil capacity (*supra* Chapter 2 at 1 *et seqq.*), then the promisor's heir (继承人) or legal representative (*supra* Chapter 2 at 26 *et seqq.*) may revoke the gift contract on behalf of the promisor.¹²⁹

- 67** The promisor needs to exercise his right to revoke by law within one year after he knew, or should have known the reason to revoke.¹³⁰ If the right to revoke by law is exercised by the promisor's heir or legal representative on behalf of the promisor, they need to exercise the right within six months after they knew, or should have known the reason to revoke.¹³¹ Once the gift contract is revoked, the promisor, his heirs, or his legal representative may recover the gift.¹³²

c. Exemption from Performance

- 68** The CL has also foreseen the situation where the promisor is unable to afford the gift after making a promise. In this situation, art. 195 CL allows the promisor to be excused from fulfilling the promise, provided that the promisor's economic condition has notably deteriorated and fulfilling the promise will severely affect his business operation or personal life.
- 69** The CL does not specifically mention whether this exemption clause is applicable to gift contracts that are for the purpose of public interest, those that have a characteristic of moral obligation, or those that have been notarized. Since the CL does not limit the scope of this exemption clause, it should be applicable even if the promisor made the promise in good faith, but later suffered significant economic hardship and was no longer able to perform the gift contract.¹³³ Where the promisor was unable to fulfill his promise at the time of its making but only made the promise for the purpose of commercial marketing, some scholars argue that the exemption

¹²⁸ *Hu Kangsheng*, 287-288.

¹²⁹ Art. 193 para. 1 CL.

¹³⁰ Art. 192 para. 2 CL.

¹³¹ Art. 193 para. 2 CL.

¹³² Art. 194 CL.

¹³³ *TANG Ming*, 70; *HU Kangsheng*, 291.

clause should be made unavailable to such a promisor and the promisee may claim for indemnity if any damage occurs.¹³⁴

4. Indemnity

The CL has prescribed a few circumstances in which the promisor is liable for the promisee’s damages. 70

a. Loss of Gifts

Pursuant to art. 189 CL, if a gift is damaged or lost due to a promisor’s intentional act or serious negligence, the promisor is liable to the promisee and should compensate the promisee for any damage or loss incurred. As self-explanatory as it is, this article has aroused some controversy among Chinese scholars. 71

Some scholars believe art. 189 is an error in the CL, because it conflicts with the promisor’s right to revoke the gift contract by free will under art. 186. For example, one scholar argues that because the promisor has the right to revoke the contract by free will, in cases where he has caused the gift to be lost or damaged, the promisor can simply revoke the contract to avoid being held liable for the damages caused. As a result, art. 189 CL is no longer available to promisees who have suffered losses. 135 Another scholar, agreeing with this opinion, describes it as an “inconformity in the Chinese Contract Law”.¹³⁶ Other scholars do not think these two articles conflict with each other. They acknowledge the situation described above, but argue that the “conflict” indicates that the indemnity provision in art. 189 only applies to gift contracts that are not subject to a promisor’s revocation by free will, i.e. those for the purpose of public interest, those that have a characteristic of moral obligation or those that have been notarized.¹³⁷ 72

The author agrees with the second opinion. In fact, a contextual interpretation of the CL supports the argument that art. 189 applies only to gift contracts that are not subject to a promisor’s revocation by free will. In art. 188, the CL provides that in gift contracts that are for the purpose of public interest, have a characteristic of moral obligation, or have been notarized, the promisee can request the promisor to deliver 73

134 *HU Kangsheng*, 291.
135 *XUE Wencheng*, 30-31.
136 *LI Zhiqiang*, 121-122.
137 *LI Guoguang*, 907-908; *WANG Wenjun*, 145.

the gift when the promisor does not voluntarily do so.¹³⁸ The following article, art. 189, further discusses the situation in which the promisor shall compensate the promisee. As a result, it is reasonable to interpret art. 189 CL in the way that its application is also limited to the types of gift contracts provided in art. 188.

b. Defects in Gifts

- 74** Due to a gift contract's gratuitous nature, the CL does not require the promisor to guarantee that the gift is free from any defects.¹³⁹ This is different from the CL's requirement of the buyer in a sales contract. There are, however, two exceptions of this non-requirement stipulated in art. 191 CL. First, in a gift contract where the promisee has certain obligations, the promisor is liable for the gift's defects, as with a buyer in a sales contract, within the scope of the promisee's obligations. Second, if the promisor intentionally withholds information on the defects or guarantees that the gift is free from any defects, he should compensate the promisee for any damages caused to the promisee by the defects.

5. Protection of the Promisee's Reliance Interest

- 75** Many Chinese scholars believe that the promisor's right to revoke by free will under the CL is excessively broad, especially when the CL does not provide for any protection of the promisee's reliance interest.¹⁴⁰ This typically happens when the promisee reasonably relies on the promise and further spends time and money in preparation for accepting the gift, but the promisor later revokes the contract before delivering the gift.
- 76** Most of the Chinese scholars agree that it is only fair if the promisor is held liable and compensates for the promisee's reliance damages such as in the above situation. However, the CL, in its specific provisions relating to gifts contracts, does not offer any protection of the promisee's reliance interests. As a result, the scholars do not always agree on the authority for such a liability. Some propose that the liability should be based on the promisor's fault once the contract is revoked;¹⁴¹ others argue that the CL there should provide for a special type of liability.¹⁴² The

¹³⁸ Art. 188 CL.

¹³⁹ Art. 191 para. 1 CL; *JIANG Ping*, 154.

¹⁴⁰ *TANG Ming*, 70.

¹⁴¹ *TANG Ming*, 70.

¹⁴² *WANG Wenjun*, 146-147.

majority of the scholars support the idea that, under the CL’s current framework, the promisor is liable under the principle of *culpa in contrahendo*.¹⁴³ This means, in the process of concluding the contract, the promisor’s fault has caused the contract to become void or be revoked. According to this principle, the promisor should assume liability for this result.

In 1989, the SPC, in its reply letter to the High People’s Court of Hunan Province, **77** confirmed that a promisor should be held liable if his revocation of a gift contract has caused damage to the promisee.¹⁴⁴ Although this opinion was delivered prior to the promulgation of the CL, it is still likely that the SPC would hold a somewhat similar attitude today. The reasons for this expectation include: (i) the reasoning in the 1989 Reply Letter is consistent with the CL; and (ii) the Reply Letter has not yet been repealed and remains as a valid legal document today. As a result, although there is no clear theory or law on how a promisee’s reliance interests should be protected, Chinese courts may nonetheless recognize and protect such interests in judicial practice.

IV. Lease Contracts

1. Overview

A lease contract is a contract in which the lessor (出租人) delivers the leased object **78** (租赁物) to the lessee (承租人) for the lessee to use and to collect usufruct from, and the lessee pays rent to the lessor.¹⁴⁵ In a lease contract, the lessor retains the ownership of and the right to dispose of the leased object, while the lessee enjoys the right to possess, use, and collect usufruct from the leased object. The subject matter of a lease contract may be movables or immovables. Under the CL, although the same set of rules applies to all lease contracts, irrespective of the subject matter, some special rules are applicable to the lease of houses and apartments¹⁴⁶.

¹⁴³ ZHANG Shaoying/KAN Yunjing, 43.

¹⁴⁴ Reply of the SPC on the Gift Contract Case between Japanese Citizen Ji Pingxiao and the People’s Hospital of Hunan Province dated of 22nd May, 1989) (最高人民法院关于日本人纪平孝诉湖南省人民医院赠与一案的答复 (1989 年 5 月 22 日 (1989) 民他字第 22 号)).

¹⁴⁵ Art. 212 CL.

¹⁴⁶ For sake of convenience, when “house” or “houses” are used in this chapter, they refer to both houses and apartments.

2. The Period and Form of a Lease Contract

79 The CL imposes strict restrictions on the period and form of a lease contract. The maximum period of a lease contract is 20 years. The part of a lease contract that exceeds the 20-year limit is void.¹⁴⁷ This, however, does not mean that a lease contract, in practice, must be terminated after 20 years. When the 20-year period expires, the parties may choose to renew the contract. Nevertheless, the renewed period is still barred from exceeding 20 years.¹⁴⁸ The parties may also choose not to renew the contract, but instead, continue to perform the contract. In this case, the lease contract will be considered a lease with an indefinite period.¹⁴⁹ The CL also requires that a lease contract with a period of more than six months be in writing. If such a lease contract is not concluded in writing, the contract is deemed as a lease contract with an indefinite period.¹⁵⁰

3. Appropriate Use of the Leased Object

- 80** The lessor should ensure that the leased object is suitable for the agreed method of use, and is responsible for repairing the leased object during the period of the lease contract.¹⁵¹ If the lessor fails to perform his obligation to repair the leased object, the lessee may repair the leased object himself, with the expense to be borne by the lessor. If the repair affects the lessee's usage of the leased object, the lessee is entitled to a rent reduction or an extension of the lease period.¹⁵²
- 81** The lessee should use the leased object according to the agreed method of use or, absent a clear agreement, the nature of the leased object.¹⁵³ Upon doing so, the lessee is not liable for any damages or wear and tear caused by the normal use of the leased object.¹⁵⁴ Conversely, if the lessee does not use the leased object according to the agreed method of use or, absent a clear agreement, the nature of the leased object, the lessor may terminate the contract and recover any damages

¹⁴⁷ Art. 214 para. 1 CL.

¹⁴⁸ Art. 214 para. 2 CL.

¹⁴⁹ Art. 236 CL; *Hu Kangsheng*, 319.

¹⁵⁰ Art. 215 CL.

¹⁵¹ Arts. 216, 220 CL.

¹⁵² Art. 221 CL.

¹⁵³ Art. 217 CL.

¹⁵⁴ Art. 218 CL.

caused by such use.¹⁵⁵ The lessee should also keep the leased object under proper care, and is liable to the lessor if he fails to do so, thus causing the leased object to be damaged or lost.¹⁵⁶ With the lessor's consent, the lessee may improve or affix other things to the leased object.¹⁵⁷ If the lessee does so without the lessor's consent, however, the lessor may request the lessee to restore the leased object to its original condition or claim against the lessee for compensation.¹⁵⁸

4. Payment of Rent

The lessee should pay the rent at the time stated in the contract or, absent a clear agreement, in the following manner: if a lease is shorter than one year, the rent is due when the lease expires; if a lease is longer than one year, the rent is due at intervals of one year; if a lease is longer than one year, but the last interval is less than one year, the last rent payment is due when the lease expires.¹⁵⁹

If the lessee delays the payment of rent, or refuses to pay the rent without a justified reason, the lessor may request the lessee to pay the rent within a reasonable period. If the lessee does not pay the rent within this period, the lessor may rescind the contract.¹⁶⁰ If a third party claims any rights on the leased object, which causes the lessee's inability to use or to collect usufruct from the leased object, the lessee may request that the rent be reduced or waived.¹⁶¹ The lessee may also request for a reduction or waiver of the rent if the leased object is damaged or lost, in part or in whole, due to reasons that are not attributable to the lessee.¹⁶²

5. Defect Warranty

The above-mentioned situation, in which the lessee may request for a reduction or waiver of the rent when a third party claims rights on the leased object, also relates to the issue of defect warranty in a lease contract. Similar to a seller's obligation in a sales contract, in a lease contract, the lessor should ensure that no third party will

155 Art. 219 CL.
156 Art. 222 CL.
157 Art. 223 para. 1 CL.
158 Art. 223 para. 2 CL.
159 Art. 226 CL.
160 Art. 227 CL.
161 Art. 228 para. 1 CL.
162 Art. 231 CL. Reasons not attributable to the lessee include force majeure, accidents, or acts of the lessor with fault. See *Hu Kangsheng*, 341.

claim any rights to the leased object. If a third party does do so, the lessor is liable to the lessee.¹⁶³ If, however, the lessee knew of the defect's existence, but nevertheless chose to enter into the lease contract, then the lessor is not liable to the lessee for said defect.¹⁶⁴

- 85** The lessor is liable to the lessee for any defect in the quality of the leased object. For minor defects, the lessor is responsible for repairing them. For serious defects that prevent the lessee from normally using the leased object, the lessee is entitled to hold the lessor in default and further request a reduction in the rent, or to rescind the contract.¹⁶⁵ It is usually required that the lessee did not know the existence of the defect at the time when the lease contract was concluded,¹⁶⁶ but if the leased object poses a hazard to the safety or health of the lessee, the lessor remains liable even if the lessee did know the existence of the defect at the time when the lease contract was concluded.¹⁶⁷
- 86** One scholar further argues that mandatory legal provisions, which put restrictions on the leased object and prevent the lessee from normally using the leased object, are also considered defects under the CL. He further argues that, in judicial practice in China, such defects are usually taken as defects in quality. In these situations, the lessee may choose to hold the lessor in default, or, depending on the details of the contract, rescind the contract by relying on a serious misunderstanding of the contract or fraud.¹⁶⁸

6. Changes in the Leased Object's Ownership During the Lease Contract

- 87** Pursuant to art. 229 CL, a change in the leased object's ownership does not affect the validity of the lease contract. This is a basic principle that exists in many countries' civil laws regarding lease contracts.¹⁶⁹ The effect of this principle is that, during the period of the lease contract, even if the lessor sells the leased object to a third party, the lease contract remains binding between the third party and the lessee. The same result also occurs in situations other than a sales transaction, where the ownership of the leased object transfers to a third party. Examples may

¹⁶³ HAN Shiyuan, 69; HU Kangsheng, 337; JIANG Ping, 175; SUN Yongquan, 33.

¹⁶⁴ HU Kangsheng, 337.

¹⁶⁵ HE Zhi, 693; SUN Yongquan, 33.

¹⁶⁶ HE Zhi, 693-694; SUN Yongquan, 33.

¹⁶⁷ Art. 233 CL.

¹⁶⁸ HAN Shiyuan, 69.

¹⁶⁹ HU Kangsheng, 338-339.

include: the lessor gives the leased object to a third party as a gift, contributes the leased object to a corporation as a form of investment, or a third party inherits the leased object from the lessor.¹⁷⁰

A limitation on this principle can be found in properties under mortgage (抵押权). **88**

When a mortgage has been established on the leased object prior to the conclusion of the lease contract, once the mortgage is enforced, the buyer is not bound by the lease contract.¹⁷¹ A buyer is also not bound by a lease contract if he purchases a house that has been sealed or attached (查封) according to law by a court prior to the conclusion of the lease contract.¹⁷²

Another important principle relating to a lease contract of a house is that the lessee **89** enjoys priority in purchasing the house during the period of the lease contract. In a lease contract of a house, if the lessor wants to sell the house, he should notify the lessee within a reasonable period of time before the sale. The lessee has the priority to purchase the house on equal terms.¹⁷³ If the lessor decides to sell the house by auction, he should notify the lessee at least five days before the auction. The lessee's failure to attend the auction is deemed as a waiver of his priority.¹⁷⁴ In practice, however, some lessors of houses try to terminate their lease contracts with the lessee before selling the houses. Under such circumstances, any remedies that the parties are entitled to should be determined by relevant parts of the contract as well as the CL.

Some other limitations still exist on the lessee's priority. The situation in which the **90** lessee cannot exercise his priority in purchasing the house include: (i) the co-owner of the house exercises his priority in purchasing the house; (ii) the lessor sells the house to his close relatives, including spouse, parents, children, siblings, grandparents, grandchildren; (iii) the lessee does not manifest his intent to purchase the house within 15 days after being notified by the lessor; and (iv) a good faith third

¹⁷⁰ JIANG Ping, 176.

¹⁷¹ Art. 66 Interpretation of the SPC of Issues concerning the Application of the Security Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国担保法》若干问题的解释); Art. 20 of the Interpretation of the SPC of Issues concerning the Application of Law in Trials of Disputes over Lease Contracts for Urban Housing (最高人民法院关于审理城镇房屋租赁合同纠纷案件具体应用法律若干问题的解释), promulgated on 30th July, 2009 and effective from 1st September, 2009 (hereinafter: Interpretation of Lease Contracts for Urban Housing).

¹⁷² Art. 20 of the Interpretation of Lease Contracts for Urban Housing.

¹⁷³ Art. 230 CL.

¹⁷⁴ Art. 22 of the Interpretation of Lease Contracts for Urban Housing.

party has purchased the house and has already completed the registration.¹⁷⁵ Where the lessor fails to notify the lessee within a reasonable period of time or prejudices the lessee's priority in any other way, the lessee may claim against the lessor for compensation.¹⁷⁶

7. Sublease

- 91** With the lessor's consent, the lessee may sublet the leased object to a third party. Upon subletting the leased object, the lease contract between the lessor and the lessee remains valid. The lessee is still liable to the lessor and should compensate the lessor for any damage caused to the leased object by the third party.¹⁷⁷ If, however, the sublease took place without the lessor's consent, the lessor may rescind the lease contract.¹⁷⁸ The form and time of consent is relatively flexible. It may be in an expressed or implied form, and may also be made either before or after the sublease.¹⁷⁹
- 92** The SPC has stipulated more detailed rules regarding the sublease of a house or an apartment. For example, the period of the sublease that exceeds the remainder period of the lease contract is invalid, unless otherwise agreed between the lessor and the lessee.¹⁸⁰ If the lessor knew, or should have known about the sublease, but did not challenge the sublease within six months, he is barred from rescinding the lease contract or requesting the courts to void the sublease.¹⁸¹

8. Termination and Extension of a Lease Contract

- 93** Apart from situations already mentioned, the lessee may rescind a lease contract if the leased object is damaged or lost in part or in whole due to reasons that are not attributable to the lessee¹⁸², and such damage or loss has caused that the purpose of the lease contract cannot be fulfilled¹⁸³.

¹⁷⁵ Art. 24 of the Interpretation of Lease Contracts for Urban Housing.

¹⁷⁶ Art. 21 of the Interpretation of Lease Contracts for Urban Housing.

¹⁷⁷ Art. 224 para. 1 CL.

¹⁷⁸ Art. 224 para. 2 CL.

¹⁷⁹ *JIANG Ping*, 173; *Li Guoguang*, 1079.

¹⁸⁰ Art. 15 of the Interpretation of Lease Contracts for Urban Housing.

¹⁸¹ Art. 16 para. 1 of the Interpretation of Lease Contracts for Urban Housing.

¹⁸² Reasons not attributable to the lessee include force majeure, accidents or acts of the lessor with fault. See *Hu Kangsheng*, 341.

¹⁸³ Art. 231 CL.

In a lease contract of a house, the lessee may also rescind the contract if the house 94
is unsuitable to be used due to the following reasons: (i) the house is sealed or
attached by the courts or the government according to law; (ii) there is a dispute in
the ownership of the house; or (iii) the house is in a condition that violates a
mandatory requirement of a law or an administrative regulation on the usage
conditions of a house.¹⁸⁴

Absent a clear agreement, a lease contract should be deemed to have an indefinite 95
period.¹⁸⁵ Furthermore, upon the expiration of a lease contract, if the lessee
continues to use the leased object, and the lessor does not challenge the continued
usage, the original lease contract is considered extended with an indefinite
period.¹⁸⁶ In a lease contract with an indefinite period, both parties may rescind the
contract at any time. If, however, the lessor decides to rescind the contract, he
should notify the lessee within a reasonable period of time prior to the rescision.¹⁸⁷

In a lease contract of a house, if the lessee dies within the period of the contract, the 96
people who live together with the lessee may continue to perform the contract.¹⁸⁸
Where the lessee leases the house for the purpose of engaging in a business
operation as an individual business (*supra* Chapter 2 at 18-19) or an individual
partnership (*supra* Chapter 2 at 2 *et seqq.*), if the lessee dies, or is declared missing
or dead during the period of the contract, the people who run the business together
with the lessee or the lessee's partners may continue to perform the lease
contract.¹⁸⁹

V. Service Contracts

1. Overview

Art. 251 para. 1 CL defines a service contract is as a contract in which the contractor 97
(承攬人) completes the work according to the client's (定作人) requirement and
delivers the product to the client, and the client pays the price. There are various
kinds of work that parties may agree on in a service contract. According to art. 251

¹⁸⁴ Art. 8 of the Interpretation of Lease Contracts for Urban Housing.

¹⁸⁵ Art. 232 CL.

¹⁸⁶ Art. 236 CL.

¹⁸⁷ Art. 232 CL.

¹⁸⁸ Art. 234 CL.

¹⁸⁹ Art. 19 of the Interpretation of Lease Contracts for Urban Housing.

para. 2 CL, the most commonly seen work may include processing materials (加工), manufacturing on demand (定作), repairing (修理), duplicating (复制), testing (测试), inspecting (检验), etc. Contents of service contracts can be highly versatile, and, in practice, some service contracts may be difficult to distinguish from other types of contracts, such as sales contracts or employment contracts.

2. The Contractor's Obligation to Complete the Work by Himself

- 98** According to art. 253 para. 1 CL, the contractor should complete the main part of the work independently by using his own equipment, technology, and labor, unless otherwise agreed by the parties. This is because a subject matter of a service contract is usually unavailable on the market and has to be customized to the needs of the client. Consequently, the client only chooses the contractor based on his trust of the contractor's personal ability, experience, technology, etc. Therefore, this nature of a service contract requires that the contractor complete the main part of the work by himself, unless the parties agree otherwise.¹⁹⁰ Where the contractor engages a third party to complete the main part of the work in the contract, the contractor is still liable to the client for the product delivered. According to art. 253 para. 2 CL, the client is also entitled to rescind the contract if he did not give consent to the engagement.
- 99** The CL does allow the contractor to engage a third party to complete a minor part of the work in the contract. Upon doing so, however, the contractor remains liable to the client for the work completed by the third party.¹⁹¹ There is no definition for the "main part of the work" or the "minor part of the work" under the CL. In practice, the "main part of the work" is usually interpreted as the part of the work that is decisive of the quality of the final product, while the "minor part of the work", in contrast, is interpreted as all other nondecisive parts.¹⁹²

3. The Parties' Obligations During Work

- 100** The client has the obligation to provide assistance to the contractor if required in the process of the work. If the client's failure to provide assistance prevents the work

¹⁹⁰ *Hu Kangsheng*, 375-376; *JIANG Ping*, 195; *Li Guoguang*, 1202.

¹⁹¹ Art. 254 CL.

¹⁹² *Hu Kangsheng*, 376-377; *Li Guoguang*, 1202-1203.

from being completed, the contractor may urge the client to cooperate. If the client still refuses to cooperate, the contractor may rescind the contract pursuant to art. 259 CL. During the work, the client also has the right to supervise or inspect the contractor's work when necessary. Such supervision or inspection, however, cannot impede the contractor's normal work.¹⁹³ According to art. 258 CL, if the client changes his needs while the work is in progress and causes damage to the contractor, the client is liable for the damages.

Subject to the service contract, both parties may provide materials or blueprints for **101** the work. If the contractor provides the materials, he should ensure that the materials conform to the requirements of the contract. The client has the right to inspect these materials.¹⁹⁴ Where the client provides the materials, the contractor should also inspect the materials, and, in a timely fashion, inform the client of any inconformity in the materials.¹⁹⁵ A timely notification is also required where, in the process of the work, the contractor discovers that the blueprints or technological requirements provided by the client are not reasonable. The client is liable if his delayed response causes any damage to the contractor.¹⁹⁶

4. Delivery of Work, Payment, and Breach of Contract

Upon completion of the work, the contractor should deliver the product to the client **102** and provide the necessary technical documents as well as any relevant certificates of quality. In the event of a breach, the client may request the contractor to repair or redo the product. The client may also reduce the amount of payment, or, in case that the breach has caused damage to the client, claim against the contractor for compensation.¹⁹⁷

The client should inspect and accept the final product.¹⁹⁸ The client should also pay **103** the price according to the time frame agreed upon in the contract. Absent a clear agreement, the payment is due when the contractor delivers the product. In case of a partial delivery, the client should make a proportional payment.¹⁹⁹ If the client fails to pay the contractor, the contractor is entitled to a lien (留置权) on the product,

¹⁹³ Art. 260 CL.

¹⁹⁴ Art. 255 CL.

¹⁹⁵ Art. 256 para. 1 CL.

¹⁹⁶ Art. 257 CL.

¹⁹⁷ Art. 262 CL.

¹⁹⁸ Art. 261 CL.

¹⁹⁹ Art. 263 CL.

unless otherwise agreed upon by the parties.²⁰⁰ Pursuant to the RRL, absent an explicit agreement between the parties, when exercising a lien, the contractor should usually give the client at least two months to pay the price. If the client still cannot pay the price after this period, the contractor is entitled to either negotiate with the client and acquire the product at a certain price, or sell the product and seek satisfaction from the payment.²⁰¹

- 104** Due to the nature of a service contract, the client may rescind the contract at any time. Upon doing so, however, the client should compensate the contractor for any damage resulting from the rescission.²⁰²

5. Distinctions Between a Service Contract and a Sales Contract

- 105** Some service contracts can be difficult to distinguish from sales contracts. For example, a service contract in which the contractor manufactures certain products according to the client's specific demand, can be difficult to distinguish from a sales contract in which the seller manufactures an item according to the buyer's advance order.²⁰³ Such a distinction, however, can be significant under Chinese law. Pursuant to the Civil Procedure Law, contractual disputes are to be heard by the court at the defendant's domicile or at the place where the contract is performed.²⁰⁴ According to the SPC, service contracts and sales contracts have different places of performance. The place of performance of a service contract is the place where the work is conducted, but the place of performance of a sales contract is generally the place where the goods are delivered.²⁰⁵ As a result, determining whether or not a contract is a service contract or a sales contract is important when a Chinese court decides whether it is the proper forum to hear the dispute arising from this contract. Such a holding may also determine which section of the CL is applicable to the dispute. Therefore, this distinction remains a vital threshold issue in practice.²⁰⁶

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²⁰⁰ Art. 264 CL.

²⁰¹ Art. 236 RRL.

²⁰² Art. 268 CL.

²⁰³ *SUN Zhiyuan*, 35.

²⁰⁴ Art. 24 Civil Procedure Law (民事诉讼法), promulgated on and effective from 9th April, 1991; last revision effective from 1st January, 2013.

²⁰⁵ Art. 19-20 Opinions of the SPC on Issues concerning the Implementation of the Civil Procedure Law of the People's Republic of China, promulgated on and effective from 14th July, 1992; last revision effective from 24th December, 2008.

²⁰⁶ *SUN Zhiyuan*, 35.

Generally speaking, major differences between a service contract and a sales contract include: (i) the purpose of the contract, (ii) the availability of the subject matters on the market, (iii) a specific contractor/manufacturer, and (iv) the client's/buyer's right to supervise and inspect the work process. In a sales contract, on the other hand, the buyer does not enjoy such a right. The purpose of a service contract is to complete certain work in order to obtain a certain product. Therefore, the service contract focuses on the process of the work. The purpose of a sales contract, however, is to transfer the ownership of the goods, thus the sales contract only focuses on the goods, instead of the process of making them. The subject matter of a service contract is usually tailored to the client's needs. Most importantly, this subject matter does not exist at the time when the service contract is concluded, and is of course, not available on the market. The subject matter in a sales contract, however, may or may not exist at the time when the sales contract is concluded, and is usually available on the market. In a service contract, it is usually required that the contractor completes the work himself. The client has the right to rescind the contract if a third party completes the work without the client's consent. In a sales contract, however, the seller does not have the obligation to manufacture the goods himself.²⁰⁷ In a service contract, the client has the right to supervise and inspect the work process. In a sales contract, on the other hand, the buyer does not enjoy such a right.

One Chinese scholar proposes that in cases of doubt, a contract should be 107 classified as a sales contract.²⁰⁸ That is because, as compared to the legal principles and provisions of service contracts, those of sales contracts are more universally applicable. The majority of the legal principles and provisions of a sales contract also apply to a service contract, but not *vice versa*. As a result, if a certain contract does not fall into the special category of service contracts, it should be treated as a sales contract.²⁰⁹

6. Distinctions Between a Service Contract and an Employment Contract

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²⁰⁷ HE Zhi, 758-759.
²⁰⁸ A presumption for this scenario is that the contract can only be classified as either a construction contract or a sales contract.
²⁰⁹ TONG Xinqiu, 28.

Similarly, a service contract may also be hard to distinguish from an employment contract. For example, if A and B agree that A will clean B's house every week, and B will pay A a certain amount of money, it is not always clear whether this contract should be considered a service contract or an employment contract. The distinction matters because when personal injuries occur, liabilities in the two types of contracts will differ under Chinese law. In the above example, suppose when cleaning the house, A hurts himself, or a third party, if the contract is a service contract, B is not liable for any damage unless B had fault in the accident. If, however, the contract is an employment contract, B may be held liable to either A or the third party even if B did not have fault (*supra* Chapter 12 at).

109 Generally speaking, the key differences between a service contract and an employment contract include: (i) the purpose of the contract, (ii) the level of supervision and instruction, and (iii) completion of the work. The purpose of a service contract focuses on both the completion and the outcome of the work. An employment contract, however, focuses on the labor itself. As long as the employee provides the required labor, he is entitled to be paid even if his labor yields no results. A prominent characteristic of a service contract is that the contractor is independent from the client. Although the client has the right to supervise and inspect the contractor's work, the contractor should complete the work independently. In an employment contract, however, the employee should work under the employer's supervision and instruction. The employee is not allowed to work independently, unless so instructed by the employer. Although in a service contract, the contractor should complete the work himself, under certain conditions and with the client's consent, the contractor may engage a third party to complete the work on his behalf. In an employment contract, on the other hand, the employee always needs to complete the work himself, and cannot delegate the work to a third party.²¹⁰ Of course, in every circumstance, whether a contract should be classified as a service contract or as an employment contract always depends on the parties' detailed agreement in the contract.

110 According to one Chinese scholar, in cases of doubt, a contract should be classified as a service contract.²¹¹ This is due to the fact that a service contract is a named

²¹⁰ *He Zhi*, 761-762; *Cui Jianyuan*, 75-76.

²¹¹ A presumption for this scenario is that the contract can only be classified as either a construction contract or a sales contract.

contract, while an employment contract is an unnamed contract.²¹² As a result, classifying such a contract as a service contract may better help with resolving any dispute, because there will be more applicable laws.²¹³

²¹² Labor contracts, which evolved from employment contracts, are specifically regulated by labor laws in China. They are, however, outside the legal framework of the CL.

²¹³ *Cui Jianyuan*, 76.

Relevant Laws & Regulations

<i>Title</i>	<i>Promulgation Date</i>	<i>Effective Date</i>	<i>Last Revision Effective from</i>
United Nations Convention on Contracts for the International Sale of Goods(联合国国际货物销售合同公约)	4/11/1980	1/1/1988	---
Economic Contract Law (经济合同法)	12/13/1981	7/1/1982	Abolished on 10/1/1999
Foreign Economic Contract Law (涉外经济合同法)	3/21/1985	7/1/1985	Abolished on 10/1/1999
General Principles of Civil Law (民法通则)	4/12/1986	1/1/1987	8/27/2009
Opinions of the Supreme People's Court on Issues in Trials of Rural Land Contracts (最高人民法院关于审理农村承包合同纠纷案件若干问题的意见)	4/14/1986	4/14/1986	Abolished on 6/28/1998
Technology Contract Law (技术合同法)	6/23/1987	11/1/1987	Abolished on 10/1/1999
Opinions of the Supreme People's Court on Certain Issues concerning the Implementation of the General Principles of Civil Law of the People's Republic of China (Trial) (最高人民法院关于贯彻执行《中华人民共和国民事诉讼法》若干问题的意见(试行))	1/26/1988	1/26/1988	Several articles abolished on 12/24/2008
Reply of the SPC on the Gift Contract Case between Japanese Citizen Ji Pingxiao and the People's Hospital of Hunan Province ((1989) Min Ta Zi No. 22) (最高人民法院关于日本人纪平孝诉湖南省人民医院赠与一案的答复 ((1989) 民他字第 22 号)	5/22/1989	5/22/1989	---
Civil Procedure Law (民事诉讼法)	4/9/1991	4/9/1991	1/1/2013
Letter of the Supreme People's Court on the Application of Law in the Gas Meter Technology Transfer Contract Dispute between Wuhan Gas Company and Chongqing Instrument and Meter Factory (最高人民法院关于武汉市煤气公司诉重庆检测仪表厂煤气表装配线技术转让合同购销煤	3/6/1992	3/6/1992	---

气表散件合同纠纷一案适用法律问题的函)

Opinions of the Supreme People's Court on Certain Issues Regarding the Implementation of the Civil Procedure Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见)	7/14/1992	7/14/1992	12/24/2008
Law of Protection of Consumer Rights and Interests (消费者权益保护法)	10/31/1993	1/1/1994	8/27/2009
Principles of International Commercial Contracts (国际商事合同通则)	5/1994		5/2004
Guaranty Law (担保法)	6/30/1995	10/1/1995	---
Auction Law (拍卖法)	7/5/1996	1/1/1997	8/28/2004
Rules of the Supreme People's Court on Issues in Trials of Economic Disputes involving Economic Crime (最高人民法院关于在审理经济纠纷案件中涉及经济犯罪嫌疑若干问题的规定)	4/21/1998	4/29/1998	---
Contract Law (合同法)	3/15/1999	10/1/1999	---
Bidding Law (招标投标法)	8/30/1999	1/1/2000	---
Interpretation of the Supreme People's Court of Issues concerning the Application of the Contract Law (Part I) (最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(一))	12/19/1999	12/29/1999	---
Reply of the Supreme People's Court on the Effectiveness of Lending Contracts Concluded by a Credit Union in Violation of Relevant Provisions of the Commercial Bank Law (最高人民法院关于信用社违反商业银行法有关规定所签借款合同是否有效的答复)	1/29/2000	1/29/2000	----
Interpretation of the Supreme People's Court of Issues concerning the Application of the Security Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国担保法》若干问题的解释)	12/8/2000	12/13/2000	---
Interpretation of the Supreme People's Court of Issues concerning the Application of Law in Trials of Disputes over the Purchase and Sales Contracts of Commodity Premeses (最高人民法院关于审理商品房买卖合同纠纷案件适用法律若干问题的解释)	4/28/2003	6/1/2003	---
Interpretation of the Supreme People's Court of Issues concerning the Application of Law in	12/26/2003	5/1/2004	---

Trials of Personal Injury (最高人民法院关于审理人身损害赔偿案件适用法律若干问题的解释)

Real Rights Law (物权法)	3/16/2007	10/1/2007	---
Interpretation of the Supreme People's Court of Issues concerning the Application of the Contract Law (Part II) (最高人民法院关于适用《中华人民共和国合同法》若干问题的解释(二))	4/24/2009	5/13/2009	---
Notice of the Supreme People's Court on Correctly Applying Interpretation II to Issues concerning the Contract Law of the People's Republic of China so as To Serve the Primary Objectives of the Party and the State (最高人民法院关于正确适用《中华人民共和国合同法》若干问题的解释 (二) 服务党和国家的工作大局的通知)	4/27/2009	4/27/2009	---
Opinions of the Supreme People's Court on Issues in Trial of Disputes over Civil and Commercial Contracts under the Current Situation (最高人民法院关于当前形势下审理民商事合同纠纷案件若干问题的指导意见)	7/7/2009	7/7/2009	---
Interpretation of the Supreme People's Court of Issues concerning the Application of Law in Trials of Disputes over Lease Contracts for Urban Housing (最高人民法院关于审理城镇房屋租赁合同纠纷案件具体应用法律若干问题的解释)	7/30/2009	9/1/2009	---
Interpretation of the Supreme People's Court of Issues in Trials of Travel Disputes (最高人民法院关于审理旅游纠纷案件适用法律若干问题的规定)	10/26/2010	11/1/2010	---
Interpretation of the Supreme People's Court of Issues concerning the Application of Law in Trials of Disputes over Purchase and Sales Contracts (最高人民法院关于审理买卖合同纠纷案件适用法律问题的解释)	5/10/2012	7/1/2012	---

Part III Tort

Chapter 10. Overview

YUANSI BU

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I. The Evolution of Chinese Tort Law

1. Concept and Function of Tort Law

Like most legal terms, the concept of tort is also a borrowed one and was introduced 1 to China for the first time in the Qing-Dynasty.¹ The plain meaning of the Chinese characters for tort (侵权; *Qin Quan*) is the infringement of rights. Similar to other civil law countries, in the PRC tort law is generally regarded as a subcategory of the law of obligations.² With the passage of the Law on Tort Liability (LTL)³, some writers claim that China has broken the civil law tradition in that tort law is no longer subordinated to the law of obligations, but rather stands parallel to it, which

1 A succinct account of the borrowing of foreign tort law in China in this period: *KOZIOL/ZHU*, 329-330.
2 Details of the debate: *ZHANG Mo*, Fn. 13-29.
3 English translations by *ZHU/KOZIOL*, *Journal of European Tort Law* 2010, 362-375.

resembles the common law approach.⁴ Given the historical affinity or even heavy reliance of Chinese civil law on German doctrines, this development is indeed remarkable. One may ask: is the Chinese approach really so unique and innovative? To a certain degree, the answer is yes. The Chinese model combines the general rules of tort liability (*infra* Chapter 11) and a large number of individually named tort actions. The former characterizes the civil law approach, while the latter characterizes the common law approach to tort law. Neither French influenced civil codes nor the German influenced ones share this feature of the combination of the two.⁵ Moreover, the Chinese model relies more on the legislature in establishing special types of tort liability, while in other civil law countries it is rather the judiciary that fulfils this task. This is why a far-reaching list of individual tort instances is needed in China. Nevertheless, one must recognize that tort law may not completely be separated from the law of obligations, even though in China this systematical perception of tort law has only a purely theoretical implication. In contrast to other civil law jurisdictions, a comprehensive civil code is still unavailable in the PRC. As a result, China still lacks binding general provisions governing the entire law of obligations, which are equally applicable to tort law. Moreover, by the current model of codification of tort law, Chinese lawmaker did not succeed in clarifying the relationship between tort law and other fields of law of obligations, but merely defer the problem of harmonizing the law of obligations in a whole.⁶ Despite most recent codification, tort law is still in its early stages in China, given the fact that so far China fails to develop its own mature theory governing most major concepts such as fault, causation (*infra* at 31) and unlawfulness and many provisions in the LTL are either vague or general.

- 2 The LTL serves to protect legitimate individual rights and interests, clarify tort liability, prevent and sanction tortious conducts, and promote social harmony and stability (art. 1 LTL). Although the compensation function of tort law takes a central position in China, it is not explicitly mentioned in these multiple goals. Lacking an established liability insurance system, the financial consequences of tortious actions are usually covered by the wrongdoers themselves, not the insurance. Thus, the

⁴ YANG Lixin (2009/a), 128-129.

⁵ The template for the Chinese approach is said to be Ethiopian Civil Code, *cet seq.* YANG Lixin (2009/a), 130.

⁶ KOZIOL/ZHU, 361.

legislator often had to look for solutions not depending on the fact of who bears the costs of insurance, but depending on that of who is able to bear the actual loss,⁷ in order to provide an effective protection for the victim. Only against this background, one may understand the rationale behind many apparently illogical legislative arrangements, such as the liability based on fairness (*infra* at 20) or the liability for a falling object (*infra* Chapter 12 at 105).⁸ Correspondingly, the relationship between tort law and insurance law has not yet been intensively explored in China. With a view to policy orientation, Chinese law obviously follows the European tradition to stress the preventive function of tort law instead of the reactive approach which is represented by the US model.⁹ The punitive function is surely embodied by punitive damages applicable in a very restrictive scope – namely only to product liability. Appealing to the general public, the idea of punitive damages (*infra* Chapter 12 at 54) is still controversial in the legal academic circle, as it will arguably blur the functions of penal law and civil law.

2. Codification of Tort Law

Chinese legislature began to work on a statute on tort law in the late 1990s. **3** Previously, tort law was primarily governed by the GPCL of 1986. In 2007, the number of tort law cases brought to the court in China reached 870,000.¹⁰ This has very likely given the Chinese legislator an important impetus to quickly introduce a Law of Tort Liability (LTL). Thus, the LTL was adopted by the Standing Committee of the National People's Congress (SCNPC) instead of the NPC itself, although it has the original legislation competence for fundamental statutes of civil law, such as the LTL. The reason was assumed to be that the SCNPC with approximately 160 members, in contrast to the NPC with almost 3,000 deputies, form a manageable panel so that any uncontrollable controversies, impediments or possible delays can be more easily avoided.¹¹

⁷ Bollweg/Doukoff/Jansen, 91.

⁸ BUBLICK, 47.

⁹ See also BUBLICK, 40.

¹⁰ Report of the Law Commission of the NPC on the Major Questions of the Law on Tort Liability (Draft) (全国人民代表大会法律委员会关于《中华人民共和国侵权责任法(草案)》主要问题的汇报) dated 22nd December, 2008.

¹¹ ZHAO Lei, Report of Southern Weekly dated 13th January 13, 2010, <http://www.infzm.com/content/40198>, last visited on 17th January, 2013.

- 4 Being a part of the comprehensive civil law codification, the first draft of the tort liability law was presented to the NPC in December 2002 as a book of the envisaged civil code.¹² However, the deliberation on this draft could only be resumed after the adoption of the Real Rights Law (RRL) in March 2007. Apparently, the codification of the RRL has consumed so much legislative resources that the left resources were insufficient to complete the LTL. A new official draft, finalized in December 2008 and published in November 2009 to solicit public opinions, was approved after the fourth reading on December 22-23, 2009. The goal of the LTL is, on the one hand, to create a modern civil liability law and, on the other hand, to add a further building block for the codification of the entire civil law in China. Somehow disappointing is the fact that the LTL has introduced only a limited number of innovations with a total number of 92 articles. It is rather the existing law that has been consolidated.
- 5 The LTL is divided into twelve chapters: “General Provisions”, “Liability Prerequisites and Forms”, “Liability Releasing or Reducing Circumstances”, “Special Provisions on Liable Persons”, “Product Liability”, “Automobile Liability”, “Liability for Medical Malpractice”, “Environment Liability”, “Risk Liability”, “Liability for Animals”, “Liability for Risks Arising from Property”, and “Ancillary Provisions”. The first four chapters are supposed to serve as a general part in their functions, whereas the other chapters contain the special liability types. This concept has however not been consistently realized. In particular, the chapter on liable persons is classified as a general part, but actually already includes several special types of torts.
- 6 Following the common practice, foreign laws were taken into account during the legislative process. During visits to foreign countries, numerous comparative law seminars were arranged for the preparation of the drafts. Regulations and practical experience in Germany, Austria, the Netherlands, Poland, Japan, and the USA were analysed in terms of specific issues such as punitive damages, compensation for immaterial damage, automobile liability, liability for medical malpractice, as well as environment liability. Certain civil codes of European countries, the third Restatement of Torts of the United States, and the Volume VI of the “Draft Common Frame Reference (DCFR)” were drawn on as regulatory models. Foreign experts were invited to China to attend symposiums with the participation of Chinese

¹² A short description of the content of this draft in English: KOZIOL/ZHU, 332 Fn. 15.

scholars and delegates of the NPC. In the areas of special torts, the LTL is significantly influenced by the third Restatement of Torts.¹³ The LTL is characterized by the approach of mixed borrowings, in line with other fields of civil law. An example cited by commentators involves the liability for medical malpractice: the LTL adopts both the two subcategories of medical negligence – medical scientific error and medical ethical error – from French law, and product liability for medicine from US law.¹⁴

3. Sources of Law

Chinese tort law is primarily statutory law. It mainly consists of the newly enacted 7 LTL, the General Principles of Civil Law (GPCL),¹⁵ “Opinions of the Supreme People's Court on Several Issues concerning the Implementation of the GPCL of the People's Republic of China (Trial Implementation)”¹⁶, “Interpretation of the Supreme People's Court on Several Issues Concerning the Law Applicable in Hearing Cases of Compensation for Personal Injury”¹⁷, as well as the “Interpretation of the Supreme People's Court on Several Issues Concerning the Ascertainment of Compensation Liability for Non-Material Damages in Civil Torts”.¹⁸ In addition, there are a great number of judicial interpretations in the form of SPC replies to specific questions dealing with tort law, for instance prerequisites of defamation. Some administrative statutes, such as the Environmental Protection Law¹⁹, and commercial law statutes, such as Anti-Unfair Competition Law²⁰, also contain individual provisions on civil liability.

One challenging issue deals with the relation between the LTL and other special 8 statutes as art. 5 states, “Where any other law provides otherwise for any tort liability in particular, such special provisions shall prevail.” This provision somehow creates the impression that the LTL only plays a secondary role in determining tort liability

13 YANG Lixin (2009/1), 134.

14 YANG Lixin (2009/1), 134-135.

15 BUBLICK, 39.

16 最高人民法院关于贯彻执行《中华人民共和国民法通则》若干问题的意见(试行), promulgated on April 2, 1988 and effective from 26th January, 1988 (thereinafter: **Opinions on the GPCL**)

17 最高人民法院关于审理人身损害赔偿案件适用法律若干问题的解释, promulgated on 26th December, 2003 and effective from 1st May, 2004 (thereinafter: **Interpretation on Personal Injuries**)

18 最高人民法院关于确定民事侵权精神损害赔偿若干问题的解释, promulgated on 8th March, 2001 and effective from 10th March, 2001 (thereinafter: **Interpretations on Mental Damages**)

19 环境保护法, promulgated on 26th December, 1989 and effective from 26th December, 1989.

20 反不正当竞争法, promulgated on 2nd September, 1993 and effective from 1st December, 1993.

as its applicability is rejected where there is another statute covering the legal consequence based on the same facts. This understanding is rather inaccurate.

- 9 First, in resolving the relation between the LTL and other special laws, one must also consider the hierarchy of legal norms in the Chinese legal system and other universal rules for the application of laws such as *lex specialis derogat legi generali* and *lex posterior derogat priori*. That means, only a law at the same level of the LTL or at a higher level is able to derogate the LTL. Administrative regulations issued by the State Council, provincial governments, or local regulations promulgated by provincial parliaments are inferior to the LTL in the norm hierarchy and thus incapable of derogating the LTL. For this reason, the expression “any other law” in art. 5 LTL is to be construed as only including national statutes promulgated by the NPC or the SCNPC. An example may be found in the liability for medical damage (*infra* Chapter 12 at 68).
- 10 Second, some 40 national statutes still contain provisions relating to civil tort liability.²¹ Compared to the LTL, they are *legi speciali priori* (older special laws). By virtue of art. 5 LTL, they enjoy priority in the application if there is a deviation between these statutes and the LTL.²² Therefore, the key point in solving law application problems is to identify deviations. A deviation is to be reaffirmed when both a special statute and the LTL have set out different rules on the same issue (examples *infra* Chapter 12 at 52). Disputable is the case where an issue is addressed either only by the LTL or only by a special statute. In such a case, one has to examine whether the legislator intended to introduce such a deviation based on the legislative history. An example is the difference between the Product Quality Law²³ and the LTL in terms of the definition for product and defect (*infra* Chapter 12 at 50). However, the provisions in the GPCL pertaining to torts do not qualify as special provisions in the sense of art. 5 LTL, because the GPCL is, in its scope, even broader than the LTL. Therefore, a leading scholar is of the (albeit a minority) opinion that provisions in the GPCL relating to torts are no longer applicable, but instead have been already derogated by the new provisions in the LTL.²⁴

²¹ DING Guangyu/JIN Qinan citing WANG Shengming, 27.

²² DING Guangyu/JIN Qinan citing WANG Shengming, 27 and LIANG Huixing, 30.

²³ (产品质量法), promulgated by the SCNPC on 22nd February, 1993 and effective from 1st September, 1993; last revised on 27th August, 2009.

²⁴ DING Guangyu/JIN Qinan citing LIANG Huixing, 30.

Third, in terms of state liability for wrongful governmental acts, it is to assume that the LTL is only applicable when there is a loophole in the State Compensation Law.²⁵

Fourth, as to judicial interpretations issued before the LTL entered into effect, it is necessary to first examine whether there is a deviation between the two. In case of a deviation, one must solve the conflict on a case-by-case basis. An example is the provision on joint danger (*infra* at 39). Considering, first of all, the fact that some of the provisions in the LTL are actually based on previous judicial interpretations. Thus, if a deviation is caused by a deliberate amendment, the affected provision in previous judicial interpretations is no longer applicable.²⁶

4. Concurrent Liability

If a plaintiff has claims in both contract and tort based on the same facts, art. 122 Contract Law allows him to choose between the two as the legal basis for his action. In other words, the plaintiff is not allowed to sue concurrently (*supra* chapter 7 at 11).

II. Attribution Principles and Special Forms of Tort Liability

1. Attribution Principles

Arts. 6-7 of the LTL have established three attribution principles for tort liability²⁷: tort liability based on fault (过错责任) (art. 6 para. 1 LTL), tort liability based on presumed fault (推定过错责任) (art. 6 para. 2 LTL), and no-fault liability (无过错责任) (art. 7 LTL), whereby fault-based liability constitutes the basic form of tort liability. Tort liability, based on presumed fault, differs from fault-based liability in that rather than the plaintiff prove the defendant is at fault, the defendant has to debut the existence of fault. In the Chinese context, strict liability (严格责任) and no-fault liability are used as synonyms. Given the different understandings of strict liability in

²⁵ (国家赔偿法), promulgated on 12th May, 1994 and effective from 1st January, 1995; last revised on 1st December, 2010. See DING Guangyu/JIN Qinan, citing LIANG Huixing, 30-31.

²⁶ DING Guangyu/JIN Qinan, citing LIANG Huixing, 31.

²⁷ ZHANG Mo, Fn. 127-131 recognized four attribution principles, including liability on the basis of fairness, this book treats liability based on fairness as a principle of distribution of loss (*infra* at 19); YANG Lixin (2009/a), 131-132, believes that the attribution principles only refer to compensatory relief, not to other forms of relief, which may be claimed irrespective of fault; some authors contend that liability for presumed fault is not an independent attribution principle, WEI Zhenying, 30.

the common law system and the civil law system, it has been argued which definition is more accurate.²⁸

2. No-fault Liability

- 15** It is to infer from the wording of art. 7 LTL²⁹ that the LTL does not contain an exhaustive catalogue of no-fault liability and new types may be introduced through other statutes. The explicitly regulated no-fault liability includes among others, product liability, environment liability, and a part of the liability for animals and highly hazardous activities (高度危险活动).
- 16** Art. 69 LTL serves as a general provision of no-fault liability for the highly hazardous activities. The mainstream opinion is that the introduction of no-fault liability should be restricted to special statutes and that courts are not allowed to apply no-fault liability in cases where it is not explicitly regulated. Consequently, some believe that art. 69 LTL may not be applied standing alone, while others believe that the applicability of art. 69 LTL is independent of the existence of a special statute.³⁰ In any case, the key concept of "highly hazardous" in art. 69 LTL lacks a definition, which makes a direct application of the general clause harder and virtually undermines its relevance.
- 17** Art. 69 LTL is followed by a list of individual strict liability instances. This includes liability for civil nuclear facilities (art. 70), liability for activities in great heights, under high voltages, for subterranean excavations or high-speed rail vehicles (art. 73), liability for lost or discarded highly hazardous objects (art. 74), liability for highly hazardous objects in illegal possession (art. 75), as well as liability for unauthorised access to highly hazardous areas or storage areas designated for highly hazardous objects (art. 76).
- 18** Reduction and exemption of liability are stipulated according to the nature of the dangerous activity. For instance, "war" as a ground for exemption from liability is applicable only to damages resulting from the use of nuclear energy. "Intent by the injured party" applies to arts. 70-73 (nuclear facilities, civil aircrafts, and highly

²⁸ Xi Xiaoming, 54.

²⁹ Art. 7 says: "Should the offender assume the tort liability, whether at fault or not, for the infringement of the civil rights and interests, as provided for by law, such provisions are applicable."

³⁰ WANG Liming (2010), 156-157.

hazardous objects, etc.), whereas "force majeure" applies to arts. 72-73. Arts. 75 and 76 allow for liability exemption or mitigation if the operator of an installation has adopted safety measures or if he has fulfilled his duties of providing warning in the face of potential danger. Additionally, no-fault liability may be combined with a statutory cap of liability amount with respect to railway traffic accidents (bodily harm: RMB 150,000)³¹, civil aviation accidents (bodily harm: RMB 400,000)³², and ocean transport accidents (bodily harm: RMB 40,000)³³.

3. Special Forms of Tort Liability

Besides the three attribution principles, Chinese law provides for three peculiar tort liability forms (侵权责任形态): fairness liability (公平责任) (art. 24 LTL), supplemental liability (补充责任) (art. 32 para. 2, art. 34 para. 2, art. 37 para. 2 and art. 40 LTL), as well as the false joint and several obligation (非真正连带责任) (art. 43 para. 3, art. 44, 52, 53, 59, 68, 83, 85 and 86 LTL). It is to note that these concepts only deal with the distribution of loss, and constitute no independent attribution principles. The term of "tort liability forms" is modelled allegedly after the provisions on apportionment of liability in the Third Restatement of Tort Law.³⁴

a. Fairness Liability/Equity Liability

Fairness liability or equity liability has been controversial ever since being introduced for the first time by art. 132 GPCL. Fairness liability refers to the situation in which the damage is split between two parties based on factual circumstances, when neither the injured party nor the injuring one bears responsibility for the damage. Typical cases in the judicial practice involve damage inflicted on someone in sport games, where there was no breach of game rules by the one who caused the injury. In the same situation, liability is denied in both the US and European countries on the basis of assumption of risk, and a victim is required to claim compensation from

³¹ Regulation on the Emergency Rescue, Investigation and Handling of Railway Traffic Accidents (铁路交通事故应急救援和调查处理条例), promulgated by the State Council on 11th July, 2007 and effective from 1st September, 2007.

³² Provisions on the Limited Compensation Liabilities of Carriers in Civil Aviation Transport (国内航空运输承运人赔偿责任限额规定), promulgated by the State Civil Aviation Administration on 28th February, 2006 and effective from 28th March, 2006.

³³ Provisions of the Limitation of Liability With Respect to the Carriage of Passengers by Sea Between the Ports (港口间海上旅客运输赔偿责任限额规定), promulgated by the Ministry of Traffic on 17th December, 1993 and effective from 1st January, 1994.

³⁴ YANG Lixin (2009/a), 135-136.

the insurance company. In China, the justification for fairness liability is seen primarily in the superior financial situation of the injuring party. Being perceived as a penalty for the rich, and in light of the broad discretion granted to judges in determining whether or how to apply this liability, a great number of commentators advocated abolishing fairness liability in the LTL. Lawmakers did not adopt this proposal, but just amended the relevant language and made it clear that fairness liability only deals with a form of distribution of loss, and not a principle of attribution.

- 21** According to art. 24 LTL, fairness liability is applicable only in cases where no party is at fault for the damage. That means, there must be a case of fault-based liability or liability based on presumed fault at stake, and neither the victim nor the injuring party acted at fault, because the injuring party would otherwise be liable anyways if he were subject to no-fault liability. It is however obscure what factual circumstances are to be taken into account in applying fairness liability. In judicial practice, courts usually first consider the financial situation of the victim, that of the injuring party, and the gravity of the damages. Due to its questionable justification, there is a consensus to limit fairness liability only to exceptional cases.³⁵

b. Supplemental Liability

- 22** Supplemental liability stipulated in the LTL may further be divided into complete supplemental liability (完全的补充责任) and corresponding supplemental liability (相应的补充责任). The complete supplemental liability is easier to understand. A typical example is parent's liability for a minor (*infra* Chapter 12 at 13). When a child causes harm, the compensation to the victim is to be first paid out of the child's property, and if it is insufficient, the rest is to be paid out of the parent's assets. By contrast, the meaning of corresponding supplemental liability is less clear. The LTL provides three cases of corresponding supplemental liability in art. 34 para. 2, art 37 para. 2, and art. 40 h.s. 2. The corresponding supplemental liability can be construed as a milder form of complete supplemental liability as it does not require the person bearing supplemental liability to fully stand in for the person bearing primary liability in cases of a default, but only to the extent of the accountability of the complementarily liable person. The direct wrongdoer is primarily liable and the person bearing duty of care is additionally liable to pay compensation. Construed

³⁵ KOZIOL/ZHU, 340-341.

from the legislative goal, the scope of art. 37 para. 2 and art. 40 h.s. 2. LTL is to be confined to cases where the direct wrongdoer has acted intentionally. If harm is caused by the negligence of the direct wrongdoer as well as that of the person bearing duty of care, it seems unjustifiable to require the direct wrongdoer to be primarily liable and the person bearing duty of care to be complementarily liable.³⁶ In this case, art. 12 LTL is applicable.

It is controversial as to whether the person bearing supplemental liability may be **23** required to pay the full amount of the total compensation.³⁷ The opinion of denying full liability with respect to corresponding supplemental liability and reaffirming it with respect to complete supplemental liability is preferable.³⁸ The reason is that, with regard to corresponding supplemental liability, the ground for the imposition of the liability is not the financial situation, but the misbehaviour of the person bearing supplemental liability. Therefore, it is only logical to require him to bear the share of the damages that corresponds to his fault.³⁹

Equally controversial is the question of whether the person bearing supplemental **24** liability may claim recourse from the person bearing primary liability. While the majority of scholars assume that a claim to take recourse against the person bearing the primary liability is barred, art. 6 para. 2 of the Interpretation on Personal Injuries clearly allows such a claim to recourse.⁴⁰ The SPC's rule clearly merits endorsement as the liability bore by the person without primary liability is supplemental in nature and would have been rejected should the person bearing primary liability be able to compensate the entire loss.

In its systematic embedment, supplemental liability does neither belong to joint and **25** several liability in that the victim may not always claim full compensation from the supplementary liable person. Nor does it belong to proportion liability because the share of the person bearing primary liability and that of the person bearing supplemental liability cannot be clearly determined. The supplemental liability is insofar advantageous for the injured party, as it does not follow the principle of "all or

³⁶ *Guo Mingrui*, 15.

³⁷ *YUAN Xiuting*, 107, rejects full payment.

³⁸ *Guo Mingrui*, 14-15.

³⁹ Of the same opinion: *Xi Xiaoming*, 272 and *Guo Mingrui*, 15.

⁴⁰ *Guo Mingrui*, 15; undifferentiated *Xi Xiaoming*, 297.

nothing” and the injured party is enabled to obtain at least a part of the compensation.

c. Non-Genuine Joint and Several Liability

- 26** A typical example of the non-genuine joint and several liability in tort law concerns the relation between a producer and a distributor in product liability. Although a distributor is liable in material law only when the product defect is attributed to his fault, he may be required to pay the full compensation if the injured party chooses to only sue the distributor. The distributor on his part can claim indemnification against the manufacturer, if he bears no fault. This means that every non-genuine joint and several debtor is liable as a genuine joint and several debtor in external relations, and can claim the full contribution from the ones actually liable internally. Of course, the defendant may apply to the court to join the third party as a co-defendant so that the court is able to determine the liability of the defendant and of the third party in a single proceeding.
- 27** Both non-genuine joint and several liability and supplemental liability are meant to do nothing else than to shift the insolvency risk of the ones factually liable, originally carried by the injured party, to another person that is likely related to the ones factually liable. These liability forms may indeed be arbitrary and inequitable for a person, who did not cause the damage and may be sued by the injured party only on the ground of his superior financial situation. From the view of the legislator and the jurisprudence they are however justified because of the better legal protection for the injured party.

III. Prerequisites of Tort Liability

- 28** As mentioned above (*supra* at 1), Chinese lawmakers did not put much emphasis on the controversies about the prerequisites of tort liability. Apparently, scholars are just as little interested in developing indigenous theories about basic tort law issues beyond the introduction of doctrines from other law systems.

1. Conduct

- 29** A tortious act may take the form of positive act or omission if the tortfeasor has a legal duty to act. Such a duty may be assigned by statutes or judicial interpretations,

or arises due to a prior voluntary conduct. A typical example is duty of care imposed on a person who creates or maintains a potential danger to the public to protect victims from harm associated with said danger.

2. Damage

The second prerequisite is damage. Damage is defined as impairment or loss of personal or property rights as well as legally protected interests resulting from a conduct or an occurrence.⁴¹ It has also been discussed in this context in China whether pure economic loss is compensable (*infra* Chapter 11 at 13).⁴² There are already numerous decisions in this field that confirm the compensability of pure economic loss. Such cases involve i.e. the damage suffered by an heir because of the invalidity of a testament, which was drafted under the advice of an attorney. **30**

3. Causation

A further prerequisite is causation. However, it is still subject to discussion as to what causation refers to and how it is to be determined. With respect to the content, three main scholarly theories define causation as either the causal link between the conduct and the damage, or the one between the illegal misconduct and the damage, or the one between fault and the damage.⁴³ However, no prevailing view has been developed yet. Although the inclusion of illegality or fault in the causation intends to narrow tort liability in cases where the causation is rather remote, the necessity of this approach is doubtful. There is a risk that boundaries between the different prerequisites get blurred. Commentators and case law have not yet reached a consensus on the adoption of a certain theory from foreign legal systems in determining causation.⁴⁴ With respect to the test to be applied to the proof of causation, proximate causation (相当因果关系)⁴⁵ has apparently replaced mandatory causation (必然因果关系)⁴⁶ and become the generally accepted standard. To avoid unreasonable extension of the scope of liability, the **31**

⁴¹ YANG Lixin (2009/b), 106.

⁴² GE Yunsong, 217.

⁴³ YANG Lixin, 115 et seq.

⁴⁴ WANG Liming, 449 et seq.; YANG Lixin, 114 et seqq.

⁴⁵ Proximate causation is usually defined as a fact that the conduct is sufficient to cause the result under the same circumstances according to the usual social experience.

⁴⁶ Mandatory causation is usually defined as an inherent and positive relationship between the conduct and result.

foreseeability test is also applied to exclude liability for injury or damage that was unforeseeable at the time. In the judgements, even those by the SPC, the causation is often laconically affirmed or declined with one or two sentences.

4. Fault

- 32** The last prerequisite is fault. This term is avoided in other foreign legal systems,⁴⁷ while it is widely used in the LTL. However, no legal definition is given for fault. As a result, the meaning of this term is controversial. Generally, fault can be determined either through the subjective approach by examining the wrongdoer's state of mind towards the consequences of his act or the objective approach by examining the wrongdoer's discharging his legal duty of care required for social interaction.⁴⁸ As suggested by this description, the subjective test is particularly applicable to identify intent, which is expressed by the desire of the tortfeasor as to the formation of the harm, while the objective test is more suitable to determine negligence. Negligence is understood as a state of mind where the person has failed to fulfil the pertinent duty of care due to ignorance or credulity.⁴⁹
- 33** In theory a mixed approach is favoured in China⁵⁰, meaning that fault is seen as a subjective element, which should be normally determined according to objective (the conduct of the tortfeasor) and subjective (the state of mind of the tortfeasor) criteria.⁵¹ That means, even in case of intent, it may be inferred from the conduct of the tortfeasor.⁵² The standard is the care to be exercised by a reasonably prudent member of the relevant social group in the same situation, regardless of individual knowledge, capacity, or experience.⁵³ In the decisions though, even those made by the SPC, courts usually only examine whether the injuring party acted culpably without specifying whether the act was intentional or negligent.

5. Illegality

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⁴⁷ *Brügemeier/Zhu*, 50.

⁴⁸ *ZHANG Mo*, 434-436.

⁴⁹ *WANG Shengming*, 41; *Xi Xiaoming*, 50.

⁵⁰ *ZHANG Mo*, 434.

⁵¹ *WANG Shengming*, 41-42; *Xi XIAOMING*, 50.

⁵² *WANG Shengming*, 41; *ZHANG Mo*, 435.

⁵³ *WANG Shengming*, 41; *Xi XIAOMING*, 50.

Illegality is still not deemed a prerequisite of tort liability. The discussion among commentators on the question of whether unlawfulness should be treated as an unwritten prerequisite, as it is understood by the prevailing view,⁵⁴ will surely continue. Illegality was explicitly stipulated as a prerequisite for tort liability only in the Answers of the SPC on Several Issues Relevant to the Trial of Cases Involving Rights to Reputation⁵⁵, promulgated on 7 August 1993. In the published decisions no clear conclusion can be drawn as to whether this element actually plays a role in determining tort liability. The discussion related to this topic in China is still limited to an account of the relevant discussion in Taiwan, which was heavily influenced by German law.⁵⁶ In particular, it has been pointed out that both illegality and fault have an objective and a subjective aspect. Basically, the element of illegality carries a filter function so that the scope of tort liability can be constrained. In legal literature, it has been debated above all whether this function can be fulfilled by other prerequisites such as fault.⁵⁷ On the basis of European legal literature, some pointed out that the filter functions of illegality and fault are of a different kind. The legally protected interests are restricted by means of illegality and accountability by means of fault.⁵⁸ It has also been discussed that illegality may be helpful for determining fault.⁵⁹

IV. Liability of Several Persons

One of the most controversial issues touches upon liability of several persons. **35** Accordingly, arts. 8 to 14 LTL are dedicated to this complexity of problems. In Chinese law, the broader sense of “joint tort” (共同侵权) generally involves the following constellations of the liability of several people: joint wrongdoing (共同侵权) (art. 8), participation/abetment (帮助/教唆) (art. 9), alternative causation (art. 10), and incidental causation (arts. 11-12). The use of the terminologies is still inconsistent; therefore, joint tort in a narrower sense and participation/abetment are also called joint conduct (共同加害行为), while alternative causation and incidental

⁵⁴ Proponents include YANG Lixin, 101 *et seq.*; different opinions: WANG Liming, 346 *et seq.*, 522 *et seq.* Summary of the discussion, YE Mingyi (2007), 70-71.

⁵⁵ 最高人民法院关于审理名誉权案件若干问题的解答.

⁵⁶ Cf. CHENG Xiao (2004), 41 *et seqq.*

⁵⁷ WANG Liming, 522 *et seqq.*

⁵⁸ YE Jinqiang (2007), 101.

⁵⁹ YE Mingyi, 102.

causation are also called joint danger (共同危险) and joint cause (共同原因), respectively.

1. Joint and Several Liability

- 36** Prior to the passage of the LTL, a gap used to exist between theory and practice with respect to joint and several liability (连带责任) in China. In theory, any person bearing joint and several liability is liable up to the full amount due and the claimant is allowed to decide whom he sues first. In practice, the “Interpretations on Personal Injuries” requires the claimant to sue all joint and several tortfeasors in the same lawsuit, while the liability of the not sued tortfeasor is otherwise regarded as released. The SPC justified this provision with the necessity to handle a compensation case in a single proceeding.⁶⁰ Otherwise, there would be a risk that the victim obtains two decisions against each part of the joint and several debtors and, thus, double compensation.⁶¹ Pursuant to art. 13 LTL, the victim is entitled to choose between suing any one or all of the wrongdoers. By this provision, the previous practice has been rectified.
- 37** Art. 14 LTL stipulates the apportion between joint and several tortfeasors and establishes a rule of contribution. If the proportion of each party may be established based on the respective responsibility, everyone is liable for his own proportion, otherwise all of them are equally liable. Where a joint tortfeasor has paid more than he owes, he is entitled to claim contribution from any other tortfeasor.

2. Joint Tort (共同加害)

- 38** Art. 8 LTL says, “If two or more persons commit a tortious act and thus cause damage to a third party, they bear joint and several liability.” In its wording, art. 8 is almost identical to art. 830 para. 1 of the German Civil Code. It is yet unclear whether joint tort requires an intentional concerted action or can be based on the mere collective negligence.⁶² Since incidental and alternative causation are both recognized in the LTL, the negligent joint tort is presumably already covered by one

⁶⁰ *Xi Xiaoming*, 74 et seq.

⁶¹ *JIANG Qiang*, 17.

⁶² For a detailed account on this discussion, see *ZHANG Mo*, 445-449; In favour of the first opinion: *CHENG Xiao* (2003), 100; *CHENG Xiao* (2010), 128; *ZHOU Youjun*, 86-87; *Xi Xiaoming*, 67 et seqq. In favour of the second opinion: *WANG Liming* (2004), 693, 698; *YE Jinqiang* (2010), 69-70.

of these two legal concepts,⁶³ as in German law.⁶⁴ That means, joint tort in the sense of art. 8 LTL requires a “communication of volition” (意思联络), the existence of which is to be established where all wrongdoers were aware of the harm and jointly committed tortious actions with the desire to cause the harm. Art. 9 para. 1 LTL (“The instigators and accomplices take liability together with the delinquent as joint and several debtors.”) is another form of joint tort. Controversial is the question whether joint tort may be found in tortious actions subject to no-fault liability committed by several persons.⁶⁵ As in no-fault liability, fault may still exist and be determined, but made irrelevant by the lawmaker. Therefore, it is more persuasive to acknowledge that joint tort may be formed by tortious actions subject to no-fault liability, such as environmental liability.⁶⁶

3. Joint Danger/Alternative Causation (共同危險)

Art. 10 h.s. 2 LTL resembles art. 830 para. 1 s. 2 of the German Civil Code. **39** According to this provision, all participants are jointly and severally liable, if they engaged in an action that endangers the personal or property safety of another person, who is damaged by one or more participants, and the actual wrongdoer cannot be identified. A participant is not allowed to exculpate himself according to art. 10 h.s. 2 LTL, if he can only prove that he did not cause the damage. It is rather necessary to point out who is the actual wrongdoer for the purpose of exculpation. Following German legal theories, it has been discussed whether art. 10 LTL requires that a concerted action has taken place at the same time and in the same location to establish a joint danger liability.⁶⁷ For the sake of a better protection for the victim, it has been proposed that it is sufficient to invoke art. 10 h.s. 2 LTL where there is a mere connection between the tortious actions of the wrongdoers.⁶⁸ According to its wording, it can be assumed that a concerted action is not a prerequisite for the liability based on art. 10 h.s. 1 LTL. Joint fault is also not required to resort to art. 10 LTL, as this provision aims to avoid any danger to human body and property, irrespective of the intent or negligence of the acting party. The key element in

⁶³ CHENG Xiao (2010), 128.
⁶⁴ DEUTSCH/AHRENS, Rn. 187.
⁶⁵ WANG Liming (2004), 689.
⁶⁶ Xi Xiaoming, 73.
⁶⁷ CHENG Xiao (2010), 129.
⁶⁸ CHENG Xiao (2010), 129.

determining joint danger is the hazardous nature of the conduct of each tortfeasor that is highly likely to cause the harm. For example, A, B, and C have all smoked in a room and the room later burnt down due to a lit cigarette stub. In this situation, A, B, and C can be held jointly liable based on art. 10 h.s. 2 LTL because their conduct is both dangerous and apt to cause harm. Art. 10 LTL is also applicable to presumed fault and strict liability.⁶⁹

4. Joint Cause/Concurrent Causation (原因竞合)

40 Arts. 11-12 LTL govern cases in which the damage is caused by independent conducts of several persons. All wrongdoers are jointly and severally liable, if each separate conduct is capable to cause the full damage (art. 11). Where harm is caused by separate conduct of several persons, each person is liable for his own share, if the shares can be determined based on the respective responsibility or equally, if the share of the joint tortfeasors cannot be estimated (art. 12). Art. 12 actually deals with proportionate liability.

5. Summary

41 Whether these regulations can be called successful, depends entirely on the question of whether the enforcement of the victim's claim has been made easier and, at the same time, tort liability is not unreasonably extended. This in turn relies on the distribution of the burden of proof and the possibility to exculpate oneself. In this regard, legal academics and the judiciary are required to develop concretizing regulations.

42 According to its wording, art. 10 LTL should only be applicable to the unclarified cause, the so-called initiator doubt. Its applicability to cases of proportion doubt, in which even though the involvement of every participant is established, the proportion of the contribution to the result is not clarified, is principally rejected.⁷⁰ This is because art. 11 (alternative causation) and art. 12 (incidental causation) already offer rules governing proportion doubt. The commentary published by the SPC confirms, however, the applicability of art. 10 h.s. 2 LTL to proportion doubt

⁶⁹ CHENG Xiao (2010), 126 et seq.; WANG Shengming, 65.

⁷⁰ CHENG Xiao (2010), 131; WANG Liming (2010), 78.

because in this case joint and several liability arises between the participants, which is allegedly advantageous for the victim.⁷¹

V. Relief

1. Types of Relieves

The types of relieves (救济), also called liability methods (责任方式), in tort cases **43** are codified in art. 15 LTL.⁷² From a European point of view,⁷³ the necessity of this provision is difficult to understand, since art. 15 LTL does not name the requirements of the application of each of the relief forms. These are instead enumerated in the subsequent provisions of the LTL. In contrast to art. 134 para. 1 and art. 2 GPCL, art. 15 LTL takes out only two forms of contractual liability – namely repair and contract penalty. Apart from that, both provisions are identical. The theoretical structure behind the enumeration in art. 15 LTL is rather difficult to recognize: the right to recover possession as well as the elimination of negative impact or recovery of the (good) reputation are two subcategories of restoration in the former state that existed if the damage had not happened – namely restitution – as understood in other civil law countries. The term of restitution obviously has a modified meaning in the LTL, since it only includes the reparation of damaged objects.⁷⁴

It is now a task of the academia and judiciary to elaborate on the elements of the **44** claim to each relief. Generally speaking, scholars agree that the injunctive relief is available independent of fault, while compensation always requires the element of fault.⁷⁵ Among the various modes of restitution, fault is usually a prerequisite.⁷⁶ Only in terms of the return of possession, the existence of fault is not required.⁷⁷

⁷¹ *Xi Xiaoming*, 89 et seq., 99 et seq.

⁷² Art. 15: „The liability methods include (1) cessation of infringement; (2) removal of obstacle; (3) elimination of danger; (4) return of property; (5) restoration of original status; (6) compensation for losses; (7) apology; (8) elimination of negative impact and rehabilitation of reputation“. For a detailed explanation of these methods in English, see *ZHANG Mo*, 468-471.

⁷³ *Brüggemeier*, 9.

⁷⁴ *WANG Shengming*, 80-81; *Xi Xiaoming*, 118.

⁷⁵ *WEI Zhenying*, 34.

⁷⁶ *WEI Zhenying*, 36.

⁷⁷ *WEI Zhenying*, 35-36.

2. Injunctive Relief

45 Of certain importance is art. 21, which sets out the requirements for interim injunctive relief and thus fills a legal vacuum. Previously, it was only in intellectual property law where interim injunctions were codified. In the LTL, injunctive relief covers cessation of infringement and the elimination of obstacle and danger and may be awarded when an obstacle or imminent threat is present, irrespective of fault.⁷⁸ Injunctive relief may also be claimed based on the RRL. To avoid conflicts between causes of action, it is proposed to set out that claims to injunctive relief are not time-barred. Procedural rules governing injunction are to be found in art. 100 Civil Procedure Law.

3. Compensation

46 Compensation can be claimed for property loss as well as for bodily injury. The principle of prohibition on unjust enrichment through double compensation in tort law was not codified despite some previous intensive discussions. Briefly speaking, this issue is differently addressed in the relevant provisions in the commercial insurance, social security benefits, and compulsory liability insurance regulations in China. Where commercial insurance is concerned, it is permissible to recover both the proceeds of the policy and the damages from the tortfeasor for personal injury (including compensation for medical treatment, nursing and care etc.), which can actually be classified as pecuniary loss. For loss arising from damaging a property right a double recovery is impermissible. In the social insurance regime, the victim is entitled to claim costs for medical treatment from the medical insurance funds only when the tortfeasor either refuses to pay compensation or may not be identified⁷⁹; the same applies to occupational injury⁸⁰. Basically, in China the insurer is conferred a right of subrogation within the scope of the proceeds it paid to the insured by the operation of law in the case of pecuniary loss.⁸¹ This, however, does not apply to the bodily injury compensated by a commercial insurer, as above outlined.⁸² By

⁷⁸ KOZIOL/ZHU, 343.

⁷⁹ Art. 30 para. 2 Social Insurance Law (社会保险法), promulgated on 28th October, 2010 and effective from 1st July, 2011.

⁸⁰ Art. 42 Social Insurance Law.

⁸¹ Art. 60 para. 1 Insurance Law (保险法), promulgated on 30th June, 1995, amended on 28th February, 2009 and effective from 1st October, 2009.

⁸² Art. 46 Insurance Law; For more details, see WANG Linqing, 49.

contrast, both medical insurance funds and occupational insurance funds are entitled to recover medical treatment costs from the tortfeasor after having advanced these expenses.⁸³ Compensation may be paid either in the form of lump sum payments or in the form of instalment payments (provided that the tortfeasor is unable to pay one), as well as for all and appropriate security provided.⁸⁴

a. Pecuniary Loss

Pecuniary loss (财产损失) in China includes the financial consequences caused by 47 infringement on property rights/interests and personal rights/interest. Thus, recovery for bodily injury contains also pecuniary loss. In this sense non-pecuniary loss refers only to mental distress. Loss arising from damage to a property right is calculated based on the value at the time of the occurrence of the damage, which is either calculated by the market price or to be estimated in another manner.⁸⁵ Both direct damage as well as subsequent damage in the form of loss of profit is compensable. However, the scope of the consequential damage is still controversial.⁸⁶

Regarding bodily injury (人身权益损害), any medical costs, nursing expenses, 48 expenses of transport to and from a hospital, reasonable rehabilitation costs, as well as the loss of income are actionable. Loss of income is assessed by multiplying the duration of medical treatment by the actual income of the victim. If his income is a fixed amount, otherwise based on his average income in the last three years, preceding the occurrence of the wrongful act. If his average income cannot be established, loss of income is assessed by the average income of the same or a comparable industry at the domicile of the court in the previous year.⁸⁷ This rather mechanical formula does not take contingencies of a reduced salary into account. It is, however, easier for judges to employ and guarantees to a certain degree legal certainty. In the case of disability, the compensation also covers the costs of suitable disability assistance equipment and disability indemnity. It also covers funeral

⁸³ Arts. 30 para. 2, 42 Social Insurance Law.

⁸⁴ Art. 25 LTL.

⁸⁵ *In the case Mao Dexian et al v Silver Colour Metal Co. Ltd.* (茅德贤、成县茨坝须弥山实业有限公司、甘肃有色地质勘查局 106 队、成县恒兴矿业有限公司与白银有色金属公司采矿权纠纷案) the SPC ruled that the tortfeasor is barred from deducting expenses from the illegal income for the calculation of damage because the tortious conduct is an intentional one, judgment of the SPC dated 17th November, 2011.

⁸⁶ *Xi Xiaoming*, 152; Department of the LAC for Civil Law (ed.), 485; *QIN Youtu/YAN Yuqiao*, 28 et seqq.

⁸⁷ Art. 20 para. 3 “Interpretations on Personal Injuries”.

expenses and death indemnity in the case of death (art. 16 LTL), where the person entitled to recover was either a close relative of the deceased or the one who actually advanced the medical and funeral expenses. Art. 17 of the “Interpretations on Personal Injuries” confers a right to annuity to those who are financially dependent on the victim and to whom the victim owes a duty of maintenance, such as children and other close relatives lacking both income and the capacity to work⁸⁸. This right is now abolished after the LTL came into effect. The dependent person can only claim a percentage of the death or disability indemnity from the victim or his relatives, which corresponds to the amount of the alimony payment.⁸⁹ By this way, the controversy⁹⁰ regarding the nature of the death or disability indemnity is supposed to be put to an end. Disability or death indemnity is a compensation for the future loss of income and can be awarded concurrently with the compensation for mental distress (*infra* at 50 *et seqq.*).⁹¹ Pursuant to art. 9 of the “Interpretations on Mental Damages”, the death or disability indemnity constitutes a compensation for mental distress, so that no additional compensation besides the above would be able to be recovered.

- 49 One of the most significant accomplishments of the LTL is art. 17, which provides the same amount of compensation instead of individualized damages in the case of wrongful death of several persons, independent of their age, profession, and other circumstances. In the past, the existing income difference between peasants and urbanites was taken into account for the calculation of loss of income⁹²; thus, the amount of damages awarded to close relatives of the deceased persons used to be different even in the same accident. Public opinion found this situation highly discriminating⁹³ and was supposed to be rectified through art. 17 LTL. Nevertheless, a closer look reveals that art. 17 LTL is only an optional provision so that the judge can decide how to apply art. 17 at his discretion.⁹⁴

⁸⁸ Art. 28 para. 2 “Interpretations on Personal Injuries”.

⁸⁹ *Xi Xiaoming*, 141 *et seq.*

⁹⁰ For a detailed account of the relevant discussion *ZHANG Mo*, Fn. 400-403.

⁹¹ *Xi Xiaoming*, 137 *et seq.*

⁹² Art. 7 der “Interpretations on Mental Damages”.

⁹³ *ZHANG Mo*, Fn. 407-410.

⁹⁴ This view is rejected by *ZHANG Xinbao*, in *DING Guangyul/JIN Qinan*, 37.

Compensation for mental distress is among the most debated issues in tort law in **50** China. Damages award for mental distress has been recognized as early as in the late 1980s by the GPCL and concretized by the two judicial interpretation: (1) Interpretations for Immaterial Damage and later (2) Interpretations for Personal Injuries. Although art. 22 LTL has established a broader rule governing the compensation for mental distress (精神损害赔偿) in the case of severe infringement of personal rights and interests (人身权益) (including bodily injury), a number of questions still remain unsolved due to the vagueness of its wording.

(1) The first question deals with the starting point of the compensation claim, **51** namely, what constitutes mental distress and whether a distinction is to be made between mental distress and mental illness. So far, one may observe a tendency in academic writings that mental distress is construed as emotional loss, which covers pain, suffering, and the loss of joy and must not actually reach the level of a mental illness.⁹⁵

(2) The second question involves the scope of rights and interests, the infringement **52** of which may trigger a compensation claim. The wording of art. 22 LTL clearly confines the claim to the infringement of personal rights and interests and thereby excludes the actionability of this claim in cases of pure economic loss. In this regard, one may further ask which kinds of rights and interests qualify as personal rights and interests. In China, personal rights and interests are divided into personality rights (人格权) and status rights (身份权). The former refers to life, health, body, rights to name, to likeness, to reputation, etc., while the latter refers to custodial rights and spousal rights, etc. It is generally accepted that the infringement on personality rights may give rise to mental damages. As to status rights, art. 2 of the “Interpretations on Mental Damages” only stipulates that the custodian is entitled to claim mental damages in a situation in which a ward is illegally separated from him. Death indemnity was also construed as mental damages for the loss of status rights (*supra* at 48).

⁹⁵ XIE Hongfei, 12.

Most notably, life, body and health are also classified as personal rights in China. This explains why the victim or its close relatives are entitled to mental damages in case of bodily harm, wrongful death, or disability.

- 54** In terms of mental damages for pure property loss, art. 6 of the “Interpretations on Mental Damages” sets out that such a compensation claim is to be reaffirmed, when an object of a high ideal value is destroyed or damaged. Whether this provision is still in effect, is questionable. Some are in favour of sustaining art. 6,⁹⁶ while others tend to abolish this provision by arguing that the victim should be allowed to claim compensation in an amount higher than the actual value of the object because of the value of affection attached to it.⁹⁷
- 55** Where the non-pecuniary loss caused by a breach of contract is concerned, case law and the majority of scholars deny its actionability by pointing out that such damage is unforeseeable for contracting parties.⁹⁸ In cases where damage arises in the course of fulfilling a contract, the victim has the right to choose between contract and tort as the basis for his claim. Should the victim pursue mental damages, he is required to opt for a cause of action in tort. A scholarly opinion sees no justification for this restriction and proposes to permit the victim to claim mental damages in a contract cause of action, if his personal rights and interests have been infringed.⁹⁹ Some have even gone further by advocating recovery of mental loss in cases of infringement on contractual rights,¹⁰⁰ even though contractual rights are generally deemed not protectable under tort law (*infra* chapter 11 at 14).
- 56** (3) The third question is related to severe infringement as a prerequisite for the compensation for mental distress. According to scholars who challenge this requirement, the previous provision (art. 8 of the “Interpretations on Mental Damages”) considers the gravity of damages only by determining what amount of compensation is more preferable, because in case of a trivial damage, courts may lower the amount of damages or make a nominal award in order to recognize the victim’s suffering.¹⁰¹ Some propose to order the wrongdoer to make a public apology or an apology in another manner in order to correct any mental damages

⁹⁶ YE Jinqiang, 89.

⁹⁷ XIE Hongfei, 14.

⁹⁸ WANG Liming, 119-120.

⁹⁹ XIE Hongfei, 13.

¹⁰⁰ YE Jinqiang, 90.

¹⁰¹ YE Jinqiang, 90

suffered by the victim instead of monetary compensation, as has been stipulated in art. 8 of the “Interpretations on Mental Damages”.¹⁰² This proposal obviously no longer deals with the core question – namely the availability of monetary compensation for minor damages.

(4) The fourth question touches upon the scope of persons entitled to claim mental damages. On the one hand, the victim itself may be the claimant (art. 3 LTL) and, on the other hand, close relatives in the case of wrongful death or the infringement on personal rights of a deceased person; pursuant to art. 12 GPCL and art. 10 of the Succession Law spouses, parents, children, siblings, grandparents and grandchildren are also entitled to such a claim. It is still controversial whether the claim of close relatives is in nature an original claim or a claim inherited from the deceased victim. Pursuant to art. 18 of the “Interpretations on Mental Damages”, the claim to compensation for pain and suffering is neither transferable nor inheritable unless the liable party has undertaken in writing to pay the compensation or the claim is pending in court. In this regard, the German law influence is clearly noticeable.¹⁰³ However, as the German Civil Code has already repealed the restriction on the transferability of the claim to mental damages in 1990, some argue that China should also follow suit. In that case, the nature of the claim of close relatives will be established as an original right of those relatives, which has already been recognized by mainstream opinion.¹⁰⁴ **57**

A further relevant question deals with the entitlement of legal persons to claim emotional damages. The existing law clearly denies this. In theory, legal persons lack the ability to feel pain and suffering. But in legal literature, there is a minor opinion recognizing the entitlement of legal persons on the basis of equal protection required by the constitution.¹⁰⁵ **58**

(5) The fifth question is related to the availability of emotional damages in no-fault liability. Both case law and scholarly writings have reaffirmed this question.¹⁰⁶ In cases involving injuries caused by high voltage, courts have already rendered awards for mental damage. On the other side, it is inferred from arts. 1-2 of the **59**

¹⁰² XIE Hongfei, 14.

¹⁰³ DEUTSCH/AHRENS, Rn. 701.

¹⁰⁴ YE Jinqiang, 90-91, 92-93.

¹⁰⁵ WANG Guanxi, 150-151.

¹⁰⁶ XIE Hongfei, 13; YE Jinqiang, 88.

“Interpretations on Mental Damage”, which stipulate the illegality and violation of public interest and public order as prerequisites for mental damages, that fault is an element of the availability of mental damages. A conclusion is drawn from this analysis that mental damages are not actionable in strict liability. Again, this conclusion fails to recognize that fault is still present in no-fault liability, it just does not constitute a requirement for liability.

- 60** (6) The sixth question asks whether gross negligence of the victim also plays a role in damages awarded for mental distress. In a sensational case tried repeatedly by different instances of courts prior to the enactment of the LTL, the plaintiff rushed to the platform as he saw the train approaching a subway station and failed to lower his speed. As a result, he slipped down from the platform to the tracks and got his legs cut off. In the final judgment, the plaintiff was awarded compensation for emotional loss in an – for the Chinese circumstances quite high – amount of over RMB 300,000.¹⁰⁷ This judgment has been challenged by a number of scholars. Ostensibly, the result is less convincing because his gross negligence was not sufficiently taken into consideration.
- 61** (7) The last question being explored in recent literature pertains to the concept of pure emotional loss. Similar to pure economic loss, pure emotional loss refers to damages not consequent upon injury to personal rights. Prior to the enactment of the LTL, the GPCL, “Interpretations on Mental Damages”, and “Interpretations on Personal Injuries” confine the availability of non-pecuniary damages to cases where personal rights or particular property rights are infringed. As the LTL allows damage awards for the infringement of both personal rights and personal interests, some argue that if someone suffers a shock as a result of witnessing a tortious action inflicted on his close relatives, the, the negative impact on the bystander qualifies as a harm to his personal interest; therefore, a claim to emotional damages is justified.¹⁰⁸ Others attempt to construe mental distress in such a situation as physical injury and thereby reaffirm the actionability of immaterial damages. However, there is so far no case law following these suggestions.

62

¹⁰⁷ *Wu Hualin v Beijing Subway*, judgment of the Beijing Xicheng District Court dated October 18, 2009.

¹⁰⁸ *Lu Xiaoming*, 133-134.

The amount of compensation for pain and suffering depends on the degree of fault of the infringing party, the gravity of the injuring action and result, the gained profit and the financial situation of the infringing party, as well as the average standard of living.¹⁰⁹ So far, there are no national tariffs guiding judges in assessing the amount of damages for mental distress.

c. Disgorging the Gain

The concept “disgorging the gain” is not a separate form of damages, but an approach to damage calculation. Art. 20 LTL allows the victim to claim the profit gained by the tortfeasor where it is difficult to calculate the concrete pecuniary damage. Absorption of the profit as a way of estimation of the damage amount has already become a common practice within intellectual property law in China. Art. 20 LTL now expands the applicability of this method to the infringement of personal rights or interests, such as the right to likeness and to name and thereby elevate art. 10 of the “Interpretations on Mental Damages”, which first introduced the concept of disgorging the gain, to a statutory rule. **63**

VI. Exclusion and Reduction of Liability

The exclusion and reduction of liability is governed by the Chapter III of the LTL and special statutes mentioned in art. 25 LTL that contains provisions related to tort liability. In China, as in other civil law countries, the defences to tort liability are basically equally applicable to intentional tort and negligence. **64**

1. Fault Offset/Concurrent Fault

In principal, art. 26 LTL stipulates that the victim’s fault constitutes a legal ground for the reduction of liability. If the damage is deliberately caused by the victim, the defendant is completely exempted from liability (art. 27 LTL). In China, this legal concept is called fault offset/concurrent fault (过失相抵/混合过错). A combined reading of arts. 26-27 LTL makes the issue rather more complicated. Since fault includes both intent and negligence, it is questionable whether the wrongdoer’s liability is completely exempted in cases of an intentional act of the victim based on art. 27 LTL, since art. 26 LTL is also applicable to this situation and only allows **65**

¹⁰⁹ Art. 10 of the „Interpretations on Mental Damages“.

liability mitigation.¹¹⁰ Among the various doctrines to construe the two provisions, one merits endorsement that art. 27 LTL is applicable only to cases where the plaintiff's fault is the sole cause for the harm. If the defendant acted at fault and thereby also contributed to the harm, it cannot be justified to fully exempt him from liability and let the victim bear the whole loss. In such a case, art. 26 LTL is applicable. From a systematic point of view, art. 27 LTL is irritating, because it is self-explanatory in that the defendant cannot be held liable if his conduct did not cause the harm because the prerequisites for tort liability are not yet met.

- 66** Moreover, art. 2 para. 1 of the “Interpretations on Personal Injuries” introduces a more precise rule in this regard: concurrent negligence of the victim is unavailable to mitigate tort liability if the injuring party acted with intent or gross negligence and there was only minor negligence on the part of the victim. As the wording of art. 26 LTL suggests that a court may, at its discretion, reduce the liability of the defendant in cases of concurrent negligence. There is no conflict between art. 2 para. 1 of the “Interpretations on Personal Injuries” and art. 26 LTL; therefore, art. 2 para. 1 is still of certain value for reference.
- 67** However, in a no-fault liability case¹¹¹, the legal situation is less clear. Basically, if the victim has acted intentionally, the applicability of liability reduction/exemption depends on whether the conduct of the defendant has also contributed to the harm. If the defendant has contributed to the harm, art. 26 LTL is applicable, which means that the defendant may only claim liability reduction. Otherwise art. 27 LTL is applicable, which means that the defendant is completely released from liability. If the victim has only acted negligently, a question arises as to whether any degree of negligence may trigger liability mitigation. According to Art. 2 par. 2 of the “Interpretations on Personal Injuries”, liability mitigation is allowed only when the victim has acted in gross negligence. Arts. 73¹¹² and 76¹¹³ LTL rather suggest that

¹¹⁰ ZHANG Mo, 459

¹¹¹ ZHANG Mo, 459; WANG Shengming, 138. There has been a debate regarding the question of whether art. 26 LTL is applicable to no-fault liability cases in the first place, because the wording “if the victim is *also* at fault for the occurrence of the harm” seems to suggest that fault on the side of the tortfeasor is somehow necessary.

¹¹² Art. 73 “Where any damage is caused by high-altitude operations, high-pressure operations, underground mining activities, or the use of high-speed rail transport, the operator shall bear tortious liability unless he can prove that the victim deliberately incurred the damage or that the damage was caused by an event of force majeure. If the injured party is at fault in the occurrence of the damage, the liability of the operator may be mitigated.” – LexisNexis translation.

there is no such threshold on the degree of negligence. However, art. 73 is alleged to be the result of a compromise in order to balance divergent interests of the operators of highly hazardous activities and social justice, therefore, art. 73 is deemed to be an exception and having no indicative value for other no-fault liability instances.¹¹⁴

2. Conduct of A Third Party

Similar to comparative negligence, the application of the conduct of a third party as a defence is also controversial. Art. 28 LTL states that a third party is liable if the damage were caused by his conduct. Comparable to art. 27 LTL, art. 28 LTL is to be construed as only covering the case where the conduct of the third party is the sole cause for the harm.¹¹⁵ Otherwise, arts. 8, 10, 11, or 12 LTL would be applicable. In fact, the rationale of art. 28 LTL is so obvious that one must question the reason for incorporating it into the LTL. As explained in scholarly writings¹¹⁶, art. 28 LTL is designed for cases in which it is not obvious at first glance whether it is the third party or another acting person that caused the harm, or where the third party cannot be found or is insolvent.¹¹⁷ It is to note, however, that art. 28 LTL is already derogated by defences specific to particular torts in the LTL, including art. 37 para. 2, art. 40 (supplemental liability between a person bound by a duty of safety and a third person), art. 44 (non-genuine joint and several liability between a producer/distributor and a third person), art. 59 (non-genuine joint and several liability between a medical institution and a third person), art. 68 (non-genuine joint and several liability between a polluter and a third person), and art. 83 (non-genuine joint and several liability between an animal owner/keeper and a third person). In these special provisions, one can clearly identify the notion to prioritize the protection of victims. The problem is how to determine who qualifies as a third person in these provisions.

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¹¹³ Art. 76 “Where any damage is caused by unauthorised access to high-risk operation areas or storage areas for high-risk materials, if the custodian has taken security measures and fulfilled his obligation to provide warnings, his liability may be mitigated or exempted.” – LexisNexis translation.
¹¹⁴ WANG Liming (2010), 163.
¹¹⁵ ZHANG Mo, 462.
¹¹⁶ ZHANG Mo, 462.
¹¹⁷ http://www.legalinfo.gov.cn/index/content/2011-11/25/content_3123470.html, last visited on January 17, 2013.

Also disputable is the question of whether the defence of conduct of a third party is applicable to no-fault liability in the case where it is not explicitly set out in the law. For instance, only concurrent fault of the victim and force majeure are explicitly made available to an operator of high-voltage electricity as statutory grounds for liability mitigation and exemption by art. 73 LTL. The case that a third party's conduct is the sole cause for the damage is actually comparable to that of concurrent fault of the victim or that of force majeure in that the third party's act supersedes the causation between the operation of high-voltage electricity and harm. It is, thus, entirely logical to allow art. 28 LTL to mitigate or to exempt the operator's liability. Some commentators argue that the third party's act only excludes the tortfeasor's fault, which is however irrelevant in no-fault liability fault; therefore, art. 28 LTL does not apply to no-fault liability.¹¹⁸ This line of argument obviously fails to consider the issue of causation.

3. Force Majeure

70 Force majeure constitutes a general liability-excluding ground pursuant to art. 29 LTL, except otherwise provided by the law. The exception mentioned in art. 29 LTL is intended to only be applicable to no-fault liability set out in arts. 70, 72 and 73.¹¹⁹ For the purpose of liability exclusion, the act of God should be solely causal for the damage. If the defendant's act has caused or aggravated the harm, it is easy to understand that he is to that extent proportionally liable. Unlike the Contract Law, the LTL does not provide a definition for force majeure. As a result, the scope of force majeure is still subject to controversy in China.¹²⁰ The discussion resembles, in its content, one in contract law (*supra* Chapter 7 at 3).

4. Self-defence and Necessity

71 Self-defence is another liability-excluding ground pursuant to art. 30 LTL, as long as the measure does not exceed the adequate level. Otherwise, the self-defending party is liable for the damage that could have been avoided in the case of having

¹¹⁸ WANG Liming (2010), 161.

¹¹⁹ DING Guangyu/JIN Qinan citing LIANG Huixing 34; KOZIOL/ZHU, 345.

¹²⁰ ZHANG Mo, 463.

taken adequate measures. It is to note that self-defence is permissible with respect to imminent danger both to the human body and to property.¹²¹

Art. 31 LTL allows the defendant to invoke necessity as a defence to his liability. If 72 damage is caused by a conduct of necessity, the person causing the occurrence of danger is liable. If the danger is caused by a natural cause, the liability of the person causing the damage is either exempted or reduced to an appropriate amount of compensation. Should the measure taken for necessity be improper or exceed the necessary level and thereby causing damage, the person causing the damage is correspondingly liable.

5. Assumption of Risk

Acting at one's own risk was a frequent discussion topic during the legislation 73 process, but in the end was left out in the final text of the LTL. It was argued that this defence may only be found in model laws such as the Restatement of Torts, DCFR and Principles of European Tort Law, but not in any national legislation.¹²²

¹²¹ ZHANG Mo, 464-465.

¹²² WANG Shengming, 131.

Chapter 11. General Provision on Tort Liability

Literature: *DING Chunyan* (丁春艳), Study on the Compensation Liability for „Wrongful Birth“ Cases (‘错误出生案件’之损害赔偿研究), *Peking University Law Journal* (中外法学) 2007, No. 6, 682-700. *GE Yunsong* (葛云松), On the Civil Interests Protected by Law on Tort Liability (《侵权责任法》保护的民事权益), *China Legal Science* (中国法学) 2010, No. 3, 37-51. *GE Yunsong* (葛云松), Ersatz des reinen Vermögensschadens und Generalklausel der deliktischen Haftung (纯粹经济损失的赔偿与一般侵权行为条款), *Peking University Law Journal* (中外法学) 2009, No. 5, 689-736. *LIANG Huixing* (梁慧星), Several Questions Regarding Law on Tort Liability of Our Country (我国《侵权责任法》的几个问题), *Journal of Jinan University (Philosophy and Social Sciences)* (暨南大学学报(哲学社会科学版)) 2010, No. 3, 2-15. *LIU Shiguo* (刘士国), Analysis of art. 2 of the Law on Tort Liability (《侵权责任法》第二条规定之解析), *Journal of Jinan University (Philosophy & Social Science Edition)* (暨南大学学报(哲学社会科学版)) 2010, No. 3, 16-20. *WANG Cheng* (王成), The Determination of ‘Right’ in the Sense of Infringement of Rights and Normative Approach to Civil Subjects’ Interests (侵权之“权”的认定与民事主体利益的规范途径), *Tsinghua Law Journal* (清华法学) 2011, No. 2, 48-70. *WANG Guanxi* (王冠玺), A Review of the Legislative Model of art. 2 of the Tort Liability Law (《侵权责任法》第二条(一般条款)的立法模式检讨——从比较法的观点出发), *Zhejiang Social Science* (浙江社会科学) 2010, No. 8, 46-53. *Xi Xiaoming* (奚晓明), Understanding and Application of the Paragraphs of the Law on Tort Liability of the People’s Republic of China (中华人民共和国侵权责任法条文理解与适用), 2010. *YANG Lixin* (杨立新), On the Generalization and Typification of Tortious Act and the Choice of the Legislative Model of Our Country (论侵权行为一般化和类型化及其我国侵权行为法立法模式选择), *Journal of Henan Administrative Institute of Politics and Law* (河南省政法管理干部学院学报) 2003, No. 1, 1-14. *YANG Lixin* (杨立新)/*WANG Lisha* (王丽莎), On Damages for Wrongful Birth and Proper Limitations (错误出生的损害赔偿及适当限制), *Northern Legal Science* (北方法学) 2011, No. 12, 13-22. *YANG Lixin* (杨立新), Twenty Questions to be Intensively Studied in the Draft of Law on Tort Liability (《侵权责任法草案》应当重点研究的20个问题), *Hebei Law Science* (河北法学) 2009, No. 2, 2-12. *ZHANG Gu* (张谷), The Tort Law, a Law to provide Relief, a Law to protect Liberty——Several Proposals for the People’s Republic of Tort Liability Act (Draft) (作为救济法的侵权法,也是自由保障法——对《中华人民共和国侵权责任法(草案)》的几点意见), *Journal of Jinan University (Philosophy & Social Science Edition)* (暨南大学学报(哲学社会科学版)) 2009, No. 2, 12-28. *ZHANG Hong* (张红), An analysis of Wrongful Birth on the Compensation Liability (错误出生的损害赔偿), *Jurist* (法学家) 2011, No. 6, 54-65. *Zhang Xinbao* (张新宝), Tort Law Theory (侵权法原理), Beijing 2005. *ZHANG Xinbao* (张新宝), General Provisions on Tort Liability (侵权行为法的一般条款), *Chinese Journal of Law* (法学研究) 2001, No. 4, 42-54. *ZHOU Yuhui* (周玉辉)/*DING Haijun* (丁海俊), Reconsideration of the General Provisions of Tort Liability (侵权责任一般条款再探讨), *Shandong University Law Review* (山东大学法律评论) 2011, No. 00, 70-81.

I. Background

Since the concept of general provision of tort liability was discovered by Chinese 1 lawyers for the first time in 2001¹, this problem has given rise to a (in its scale) impressive discussion in the legal academic circle in China. This issue is not only of theoretical value, but has also great practical implication in that it determines how courts are to identify new types of torts. This is why this book dedicates a brief chapter to this topic.

Early on, commentators in China reached a consensus that it is impossible to 2 explicitly enumerate all conceivable types of torts in a single statute. New types of torts arise over time and the legislature is unable to keep pace with the development and to timely come up with appropriate statutory solutions. Thus, the ideal model for the LTL would be a model consisting of a general provision on tort liability plus a list of established types of torts. The central question in this context is how to frame such a general provision. From this starting point, the issues of the definition, nature, normative function, and legislative approach to such a general provision were heatedly debated in the course of reshaping tort law in China in the last decade. As a result, the wording of the designated general provisions in the drafts of the LTL has undergone amendments several times. In the draft of September 23, 2008 the wording states, “The one who intentionally or negligently infringes upon another’s life, health, dignity, freedom, reputation, likeness, privacy, rights in rem, intellectual property rights, or other rights and interests, shall bear tort liability”. This draft was criticized for not mentioning unlawfulness and harm and the enumeration of rights being incomplete.² Thus, the draft of October 16, 2008 changed the wording to “The one who intentionally or negligently causes damage to another’s following civil rights and interests, shall bear tort liability: (1) personal rights, such as the right to life, to health, to name, to likeness, to reputation, and to privacy; (2) status rights, such as custodial rights, and right to be fostered (被抚养权); (3) rights in rem, such as legal ownership, easement, secured rights in rem; (4) intellectual property rights, such as copyrights, trademark rights, and patent rights; (5) other civil rights and interests.” The pertinent language was again reduced to “The one who commits tortious acts, shall bear tort liability” in the draft of December 4, 2008 and to “The one who

¹ ZHANG *Xinbao*, 42-54.

² YANG *Lixin* (2009), 2-3.

infringes upon civil rights and interests, shall bear tort liability.“ in the draft of December 22, 2008.

- 3 The different fashions to frame the general provision in the LTL reflect the controversy as to which elements amount to a general provision governing tort liability. The first question to be solved in this context is the definition of a general provision in tort law. In this regard, a distinction was made in China between a comprehensive general provision (全面的一般条款; 大的一般条款) and a limited general provision (有限的一般条款; 小的一般条款) in the pertinent discussion. The so-called comprehensive general clause refers to a clause capable to provide the basis for all tort claims, irrespective of the attribution principle (fault-based liability or no-fault liability), as well as the forms of relief (compensation, injunction etc.), while other tort law provisions only have the function to interpret and concretize the application of this clause.³ A limited general clause is deemed to only cover liability for compensation caused by one's own misconduct, namely, the fault-based tort liability for compensation.⁴ Art. 1:101 of the Principles of European Law⁵ is regarded in China as an example of a comprehensive general provision, while art. 823 of the German Civil Code⁶ is deemed as an example of a limited general provision.⁷

II. Model in the LTL

- 4 Before the codification of the LTL the issue of whether art. 106 para. 1 GPCL: “A citizen or legal person who through his own fault infringes upon the state, collective property, or upon another person's property or harms another person, shall assume civil liability.” constitutes a general provision was already subject to a heated debate.

³ ZHANG Xinbao (2001), 42.

⁴ YANG Lixin (2003), 2.

⁵ Art. 1:101. [Basis Norm] (1) A person to whom damage to another is legally attributed is liable to compensate that damage.

(2) Damage may be attributed in particular to the person
a) whose conduct constituting fault has caused it; or
b) whose abnormally dangerous activity has caused it; or
c) whose auxiliary has caused it within the scope of his functions.

⁶ Section 823 [Liability in damages]

(1) A person who, intentionally or negligently, unlawfully injures the life, body, health, freedom, property, or another right of another person is liable to make compensation to the other party for the damage arising from this.

(2) The same duty is held by a person who commits a breach of a statute that is intended to protect another person. If, according to the contents of the statute, it may also be breached without fault, then liability to compensation only exists in the case of fault.

⁷ YANG Lixin, 2.

The enactment of the LTL did not put an end to this issue. On the contrary, a new wave of controversy started around the question of whether the LTL contained a general provision and which clause constitutes such a provision. Arts. 2, 6, and 7 were generally considered as able to serve the function as a general provision:

Art. 2: “The one who injures civil rights or interests has to bear tort liability according to this law.

For the purpose of this Law, "civil rights and interests" shall include personal and property rights and interests, such as the right to life, the right to health, rights associated with names, reputational rights, honorary rights, the right to one's image, the right to privacy, the right to marital autonomy, the right to guardianship, ownership rights, usufruct, collateral rights, copyrights, patent rights, exclusive rights to use trademarks, discovery rights, equity rights, and inheritance rights.”

Art. 6: “Where an actor is at fault in infringing another party's civil rights and interests, it shall bear tortious liability.

Where an actor is presumed to be at fault by law and is unable to prove its innocence, he shall bear tortious liability.”

Art. 7 “Where an actor infringes upon another party's civil rights and interests and the law provides that it shall bear tortious liability regardless of whether or not he is at fault, such provisions shall apply.”

So far, in an attempt to construe these clauses, a number of theories have been put forward⁸: some assume that both art. 2 para. 1 and art. 6 para. 1 are general provisions, while others believe that art. 2 para. 1, art. 6 para. 1, or art. 7 constitute a general provision. In particular, it is argued that art. 2 para. 1 LTL is incapable of serving as a genuine general clause because art. 2 para. 1 fails to set out attribution principles and to indicate concrete legal consequences, so that tort liability can only be determined in conjunction with other regulations of the LTL.⁹ According to this view, art. 2 para. 1 is merely a reference clause and, standing alone, unable to serve as the basis for tort claims.¹⁰ In contrast, art. 6 para. 1 stipulates the attribution principles and can be drawn on to determine tort liability.

⁸ For a summary of the opinions, see *ZHOU/DING*, 70-71.

⁹ *GE Yunsong* (2010), 39-40.

¹⁰ *ZHOU Yuhui/DING Haijun*, 70 with further reference.

III. Rights v. Interests

1. Terminology

- 7 Art. 2 LTL employs the terminology “civil rights and interests” (民事权益). Thereby, it deals with a concept that has already been followed in the GPCL.¹¹ This term has so far triggered two fundamental questions.
- 8 The first one is whether the term “rights and interests” (权益) and the term “rights” (权利) are two different legal figures and if this is the case, how to distinguish one from the other. Again, the scholarly opinions are split on this issue.¹² Some assume that the term “rights and interests” is broader than that of “rights” and rights in the sense of art. 2 LTL only refer to codified subjective rights, while interest deals with a legal position that has not yet been explicitly acknowledged as a statutory right, but nonetheless merits legal protection. Such interests are also called legally protected interests (法益). Not codified personality rights, the interests of unborn baby, interests of the deceased, interests in fair competition, ideal interests in a certain object, and pure economic loss are cited as examples of legally protected interests.¹³ In the judicial practice, the SPC has actually recognized the existence of non-codified rights on a case-by-case basis. Some deny the existence of legally protected interests beyond codified rights by arguing that the holder of such interests may not actually dispose of such interests.¹⁴ Furthermore, such interests may not be infringed upon by negligence, but only by intent.
- 9 The second one is what sort of civil rights and interests are exactly covered by art. 2 LTL. This question is actually interrelated with the first one. In terms of civil rights, art. 2 para. 1 LTL has provided a list. However, it is unclear whether this enumeration is exhaustive and covers only absolute rights. The majority of commentators believe that the list is non-exhaustive,¹⁵ while a minority view holds that the list is to be construed as exhaustive in order to construct a functioning

¹¹ LIANG Huixing, 6-7.

¹² LIU Shiguo, 16.

¹³ LIU Shiguo, 18; ZHANG Xinbao (2005), 209.

¹⁴ LIU Shiguo, 17-19.

¹⁵ GE Yunsong (2010), 38-39.

clause to deal with non-codified interests following the example of the German Civil Code (*infra* at 3).¹⁶

2. Determination of Protected Interests

Speaking from a practical point of view, a general provision is crucial primarily in the case where the affected interest claimed by the plaintiff is not explicitly protected by a statute. It is generally acknowledged that, in order to be protected against infringement by virtue of tort law, such interest has to meet a certain threshold. The reason is that, lacking a statutory provision, a third party is unable to take notice of the existence of the claimed interest and to adjust his conduct to avoid interference therewith. The imposition of a duty of care by tort law *ex post* is not justified for it is not foreseeable at the time when the third party committed his conduct. Furthermore, the expansion of the interests protected by tort law beyond the scope of statutorily conferred rights may inevitably restrict the freedom of action of anyone else. Thus, to strike a reasonable balance between the protection of the plaintiff and the freedom of action of the defendant, a general provision should be equipped with the function of assisting a judge in reaching a right decision, where both sides have merits. Judged from this standard, all the above-mentioned clauses in the LTL and the GPCL fail to fulfill the function of a general clause. Therefore, more and more scholars propose to adopt the German model to introduce a genuinely functioning general clause.¹⁷ That means, an interest is granted legal protection where it has not yet been statutorily recognized only when it meets one of following prerequisites: (1) either it violates a protective statute (art. 823 para. 2 BGB) or (2) constitutes an intentional and conscientious tort (art. 826 BGB).

Alternatively, another doctrine considers the following factors as relevant while answering the question of which interests are protected from tortious actions based on art. 2 para. 1 LTL: (1) if these interests are protected by legal regulations; (2) if the alleged wrongdoer has acted with intent; (3) if there is a bond of reliance between the alleged wrongdoer and the injured, so that the injured can assume that

¹⁶ GE Yunsong (2010), 44-45; WANG Cheng, 68.

¹⁷ GE Yunsong (2010), 42, 44; WANG Cheng, 66-70; WANG Guanxi, 50-53; ZHANG Gu, 27-28.

there will be no injurious acts; and finally, (4) the freedom of action of third parties and the community is to be adequately considered.¹⁸

IV. Case Groups

- 12** It is still uncommon in China to summarize case groups for general provisions based on case law to facilitate law application. The discussion below addresses several cases heatedly debated in legal writings, which are supposed to be solved by the general provision of tort law:
- 13** (1) Pure economic loss (纯粹经济损失). In China, the concept of pure economic loss began to draw attention in the legal circle only since the last decade. The previous ignorance of this problem is attributed to the fact that art. 106 para. 2 GPCL is deemed broad enough to cover pure economic loss as a type of legally protected interest.¹⁹ The recovery of pure economic loss has already been warranted by some statutes and judicial interpretations, such as art. 44 PQL (*infra* Chapter 12 at 52).²⁰ Nevertheless, the relevant judicial practice is rather close to the German model in that compensation is awarded only in cases where a protective statute is violated. In absence of such a protective statute, the defendant must have acted intentionally and conscientiously.²¹ Frequently, compensation claims are denied by citing other reasons, such as lack of direct causation or lack of fault, without mentioning the concept of pure economic loss. To avoid unreasonable limitations on an individual's freedom, scholars propose to exclude recovery for pure economic loss under no-fault liability.²²
- 14** (2) Contractual rights (合同债权). The protection of contractual rights by tort law is actually a subcategory of pure economic loss. A breach of contract caused by the interference of a third person is deemed a tort under Chinese law, only when the third party is aware of the existence of the contractual relationship and the third party's act violates public policy.²³ For example, someone is only liable for inducing a breach of contract, if he offers a higher price for a commodity, although he is

¹⁸ *Xi Xiaoming*, 26-27.

¹⁹ *LIANG Huixing*, 7.

²⁰ *GE Yunsong* (2009), 703-705

²¹ *GE Yunsong* (2009), 709.

²² *GE Yunsong* (2010), 46-47.

²³ *GE Yunsong* (2009), 731.

aware that that the seller has already agreed to sell it to the buyer when he commits this act, thus, intending to hurt the buyer.

(3) General right to an individual's protection of personality (一般人格权). Under 15 Chinese law, some personality rights are explicitly protected either by the GPCL, the LTL, or other statutes such as name, reputation and likeness. However, the concept of a general right to an individual's protection of personality has not yet been codified. This poses the question of whether other personality interests are also eligible for legal protection provided by art. 6 para. 1 LTL. Again, some favour the German approach and propose that legal protection can only be granted by weighing the interests of the parties after taking into account consideration of the particular circumstances.²⁴

(4) Interest in fair competition/fair competition right (公平竞争利益/公平竞争权). The 16 Chinese Anti-Unfair Competition Law (AUCL) protects business operators against unfair competition practice, which includes passing-off, misrepresentation and fraudulent advertisement, etc. As in the case involving fraudulent advertisement, no absolute right is infringed upon, but only certain economic interests. Some believe that, in such cases, the nature of economic interests is the interest in fair competition or fair competition right. This discussion is however only of theoretical value, as it does not provide the judiciary with a viable tool to determine new types of unfair competition conduct, which is not expressly enumerated in the AUCL.

(5) Wrongful birth. Wrongful birth (错误出生/错误生命) may take different forms²⁵ 17 and in China primarily refers to the birth of a handicapped child, the handicap of whom has not been identified because of erroneous medical diagnosis. So far, the attitude of the Chinese courts toward actionability of a parent's claim to compensation are inconsistent. In some cases the plaintiff was able to recover damages and, in other cases, the claim was rejected with the argument that there is no codified right of the parents having been infringed.²⁶ In the case where compensation is granted, courts argue in different ways. Most see the basis in the parent's right to bearing and rearing better children (优生优育权),²⁷ namely, that a

²⁴ GE Yunsong (2010), 42-43.

²⁵ DING Chunyan, 682-684.

²⁶ YANG Lixin/WANG Lisha, 15-16; ZHANG Hong, 54-55.

²⁷ ZHANG Hong, 57.

parent is entitled to choose to abort an unhealthy embryo, while some construe it as a liability for medical damage²⁸. A scholarly interpretation believes the justification is based on the mother's interest of obtaining proper treatment.²⁹ The scope of compensation acknowledged by case law covers pecuniary loss, including loss of income, child maintenance costs, medical costs for the mother and the child, disability care costs, and mental distress.³⁰

²⁸ *DING Chunyan*, 694.

²⁹ *YANG Lixin/WANG Lisha*, 16, 20.

³⁰ *YANG Lixin/WANG Lisha*, 18; *ZHANG Hong*, 60-63.

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- 1 Individual named torts are primarily governed by Chapter V – Chapter XI of the LTL. In addition, Chapter IV also contains several special types of torts. The current book chapter also covers defamation – an important type of tort not addressed by the LTL, and is therefore in its systematical structure slightly different than the LTL.

I. Vicarious Liability

- 2 Vicarious liability (替代责任) is a terminology stemming from the common law system and refers to the situation where one person is held vicariously liable for a tort committed by another. As China belongs to the civil law family, vicarious liability has not been explicitly adopted by the existing laws as a special type of liability, but exists merely in legal writings to capture situations involving liabilities for the conduct

of another. A typical example of vicarious liability is the liability of an employer for a tort committed by his employee in the course of his employment.

The imposition of liability for a conduct not committed by oneself, but by another 3 person, needs justification. In China, most commentators see the rational for vicarious liability in the so-called duty of control, which means that because of the existence of a particular relationship either between the person bearing vicarious liability and the tortfeasor or a relationship between the person bearing vicarious liability and the victim, the law requires the person bearing vicarious liability to take reasonable measures to prevent the tortfeasor from committing such tortious acts.³¹

1. Liability of Employers

The employer's liability regime has undergone a significant overhaul by the norms of 4 the LTL (art. 34 *et seqq.* LTL). Art. 34 LTL imposes no-fault liability on the employer for the damage caused by the employee in the course of carrying out work-related tasks. This rule applies even if both parties of the employment relationships are natural persons (art. 35 para. 1 LTL). It is to note that according to Chinese labor law theory, employment relationship formed by two natural persons is deemed and called service relationship (劳务关系).

Under the LTL the employee is no longer liable in external relations. In contrast, art. 5 9 of the “Interpretations on Personal Injuries” stipulates no-fault liability of the employer as a basic principle and joint and several liability in the case of an intentional or grossly negligent action of the employee. The innovation brought about by art. 34 LTL is deemed to conform to the international tendency and to the preexisting norms.³² For example, art. 45 of the “Opinions on the Civil Procedure Law”³³ provides that only the employer has standing in legal proceedings regarding damage caused by the employee during the performance of production and distribution tasks as stipulated in the employment contract. Art. 42 of the “Opinions on the Civil Procedure Law” states that only a legal person has standing in legal proceedings initiated on the ground of a performing act or an authorised act of a member of its staff. Nevertheless, there is an opposite view arguing that joint and

³¹ ZHANG Minan, 54.

³² JIN Wenjing, 9 *et seq.*

³³ (最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见), promulgated by the SPC on 14th July, 1992 and effective from 14th July, 1992.

several liability provides a better protection for the victim as there is a significant bankruptcy risk when smaller companies are concerned.³⁴ In applying employer's liability, following aspects are to be taken into account:

a. Establishment of Employment Relationship

- 6 Employer's liability applies only when an employment relationship exists. To examine whether this precondition is fulfilled, one has to look at whether personal and economic dependency exists between the person to be qualified as employee and the employer according to the mainstream scholarly opinion.³⁵

b. Work-Related Tasks

- 7 The liability of the employer is limited to the scope of work-related tasks. The term "work-related task" is described by art. 9 para. 2 of the "Interpretations on Personal Injuries" as "*a production or business operation activity or any other labor service activity within the scope of authorisation or instructions of the employer*". Thus, content, time, place and beneficiary of the conduct as well as in which name the conduct is carried out and the connection between the conduct and the intention of the employer are all relevant factors in determining the existence of a work-related task. If the employee's act exceeds the scope of authorisation, but is embodied in a form of performing duties or is internally relating to the performance of duties, it is deemed an employment activity.³⁶

c. Fault and Misconduct of the Employee

- 8 The generally worded rule on employer's liability does not reveal whether fault or misconduct of the employee is required for the employer to assume liability. As the nature of employer's liability is a vicarious liability, the employer is only liable if the employee's conduct gives rises to the tortious liability. That means, fault is required when employee's conduct is subject to fault-based liability and conversely, fault is not required if the employee's behaviour is subject to no-fault liability.

³⁴ ZHANG Minan, 28 *et seq.*

³⁵ LI Guang, in: BU (ed.), Chinese Business Law, 2010, Chapter 9 at 16, 17.

³⁶ XI Xiaoming, 250.

d. Liability of Legal Person's Organs

The no-fault liability of the employer is also applicable to the conduct of organs of legal persons. Tort liability of a legal person for its organ falls under the scope of employer's liability, which are governed by art. 43 GPCL, art. 175 of the Opinions on the GPCL and art. 8 of the "Interpretations on Personal Injuries". According to these provisions, a legal person bears no-fault liability for damage caused in the fulfillment of tasks by its legal representative, officers and staff. The meaning of the word "staff" is unclear and was extended by commentators to all employees, including legal representative and officers of a legal person.³⁷

e. Right to Recourse

Internally, the recourse claim of the employer against the employee is not codified in the LTL. Apparently, the legislator intended to leave this complicated issue to be solved by judicial practice.³⁸ The validity of a contractual arrangement between the employer and the employee in this regard is generally acknowledged.

f. Labor Dispatch

In a temporary working relationship, it is the company which receives the dispatched employee who is primarily liable for misconduct of the employee. The dispatching employer is only liable in the case and to the extent of his fault (art. 34 para. 2 LTL). Art. 13 of the "Interpretations on Personal Injuries" imposes liability on the service recipient for actions of a voluntary helper in a favor relationship, comparable to the employer liability. As the LTL did not follow the proposal of commentators to incorporate this provision into the employer liability,³⁹ it remains applicable to tort liability of a voluntary helper. The liability in a service contract is not codified in the LTL, but only in the art. 10 of the "Interpretations on Personal Injuries". According to this provision, an independent contractor is liable for the damage caused to a third party. The employer is liable proportionally to his fault in the assignment, instruction or selection of the independent contractor.

³⁷ *JIANG Xueyue*, 72 et seq.

³⁸ *WANG Shengming*, 172 et seq.

³⁹ *YIN Fei*, 17 et seq.

12 Somehow difficult to understand is the provision relating to compensation for industrial injuries (工伤), a highly controversial issue in China since the late 1980s. Art. 35 s. 2 LTL allows the employee to claim recovery for damage he suffered as a result of delivering service to a *natural person employer* in proportion to the employer's fault. In fact, the codification of this rule serves to amend a previous one stipulated in art. 11 of the "Interpretations on Personal Injuries", which requires the employer to compensate bodily injury inflicted on an employee in the course of engaging in working activities. Art. 11 of the "Interpretations on Personal Injuries" has actually imposed a **no-fault liability** upon the employer as it permits the employee to recover industrial injury independent of the fact whether the employer or the employee is at fault for the damage. The no-fault liability, is now reversed to an ordinary **fault-based liability** by art. 35 s. 2 LTL if the employer is a natural person. That means art. 11 of the "Interpretations on Personal Injuries" remains still applicable when the employer is a legal person. The rationale for the differentiation between natural person employers and legal person employers lies in the fact that China has not yet managed to establish an comprehensive workers compensation regime. Thus, it seems justifiable to impose compensation liability upon a legal person who is usually financially better off than his employees and is in a stronger position to bear the loss and purchase insurance for occupational injuries, while this argument is inapplicable to a natural person employer who may usually lack such a superior financial position.

II. Children' Liability for Torts and Personal Injury

1. Parent's Liability

13 Art. 32 LTL and art. 133 GPCL provide that the guardian (usually a parent) is liable for the injury caused by a minor. The negligence or intent of the minor is irrelevant. That means, children, independent of their age, enjoy the absolute immunity from tort liability. The guardian cannot completely exculpate himself even where he has no negligence to be blamed for. Where the guardian has exercised proper control and supervision of the child, liability reduction can be claimed. Although looking similar to vicarious liability, the liability of the guardian for the torts committed by a

child actually belongs to the type of supplemental liability. That is because the estimation of the compensation's amount is determined by the financial situation of the minor based on the principle of fairness. If the child has assets, then the damage is to be covered by its assets and only the remaining amount is to be born by the guardian. This transfer of liability for the remaining amount is controversial in cases where the guardian is an institution such as a resident committee and the assets of the child cannot fully cover the compensation amount. Pursuant to art. 133 para. 2 GPCL the supplemental liability is inapplicable to institutional guardians. This exception is explained by the argument that the legislator has intended to better protect public property of an institutional guardian at the time of the adoption of the GPCL. Art. 32 LTL does not incorporate such an exception. Thus, the literature opinions are divided on whether the exception is still in effect.⁴⁰

According to commentators, the origin of art. 133 GPCL is attributed to art. 405 of 14 the Soviet Civil Law of 1922.⁴¹ Art. 32 LTL has adopted the concept of art. 133 GPCL in almost unmodified form, since the legislature did not perceive the need for a fundamental overhaul. Legal scholars have not yet become aware of the importance of this issue either. Two of the three academic drafts of the LTL followed art. 133 GPCL. Art. 32 LTL and art. 133 GPCL are arguably justified by the superior protection of victims.

Chinese civil law does not recognize the term of the capability of committing a tort 15 (responsibility for torts; 侵权能力). As a result, the distribution of liability between two children, who have caused each other an injury, is difficult, since the child's ability to judge the wrongfulness of its own act is also completely irrelevant. The judiciary tries to avoid the problem by equalizing fault of the child with fault of the guardian,⁴² which is not entirely convincing. The introduction of the capability of committing a tort has been rejected so far, since this would under certain circumstances result in the risk that an injured party will not be compensated because the child lacks the capability of committing a tort.⁴³

16

⁴⁰ According to *WANG Shengming*, 162, the safe harbour provision has already been repealed by art. 32 LTL.

⁴¹ *WANG Zhu* (2008), 143.

⁴² *Xi Xiaoming*, 208.

⁴³ *WANG Shengming*, 162,

Adults are in principle liable for the injury caused in a temporary state of unconsciousness or temporary loss of the capacity to control one's behavior, if the state was brought about with fault. If there is no fault, the acting party is responsible for an appropriate compensation corresponding to its financial situation (art. 33 para. 1 LTL). Is the temporary state of unconsciousness or the temporary loss of the capacity to control one's behavior triggered by alcohol or drugs consumption, the liability exclusion or reduction is excluded, for someone who puts itself in a state of intoxication already acts negligently.

2. Liability of Educational Establishments

- 17** A heatedly discussed issue is the liability of kindergartens, schools and other educational establishments for injury caused to children during their stay for the purpose of studying or living. Even though the number of accidents in educational establishments has not increased over the years, the perception of this problem has changed, since the majority of children in China are children without siblings due to the implementation of one-child policy in China. In comparison to art. 7 of the "Interpretations on Personal Injuries", arts. 38 and 39 LTL have introduced a set of more detailed rules: as a principle, an educational establishment assumes the liability for injury caused to a child under 7 years old. The educational establishment may exculpate itself if it is able to prove that reasonable educational and managerial duty has been discharged; thus, this liability belongs to liability for presumed fault; an educational establishment assumes a regular tort liability for an injury inflicted on children over 7 and below 18.
- 18** Is an injury caused by someone that is not employed by the educational establishment, such as other children or classmates, the educational establishment bears supplemental liability pursuant to art. 40 LTL only when it fails to adequately discharge its educational and managerial duty. The supplemental liability of educational establishments is restricted to the space of the educational establishment and to regular schooldays. In practice educational establishments are getting used to purchase liability insurance to hedge the considerable liability risk.

III. Liability based on Legal Duty to Maintain Safety

19

Chinese law borrowed the concept of legal duty to maintain safety from German law⁴⁴ and codified liability based on safety duty for the first time in 2003 in art. 6 of the “Interpretations on Personal Injuries”. Systematically, legal duty to maintain safety is necessary for the case where liability is caused by omission. Art. 37 LTL has principally adopted the same approach as art. 6 of the “Interpretations on Personal Injuries” so that now operators of hotels, stores, banks, stadiums and places of public entertainment as well as hosts of public events are imposed upon a legal duty to maintain safety. It is argued by scholars that only certain groups of people are beneficiaries of the safety duty in the specific case instead of everyone.⁴⁵ For instance, it is controversial whether a person that has illegally entered into a hotel with the intention to steal may benefit from the safety duty. Therefore, it is suggested that the group of people and the scope of the safety duty be established on the ground of the concrete circumstances. The particularities of the sector, the characteristics of the region as well as the range of the event, the nature of the tort, and the precaution measures are to be taken into consideration.⁴⁶

The liability of internet service providers set out in art. 36 LTL constitutes an **20** example of liability based on safety duty. Although the number of the Chinese internet users is the largest worldwide and the infringements of intellectual property and personal rights are commonplace in China, art. 36 LTL is nothing but a rather rudimentary provision. Pursuant to art. 36 LTL, the internet provider has to remove the ostensibly infringing content by deletion, screening or disconnection, after it has been informed by the victim. Otherwise, the internet provider is jointly and severally liable with the content provider for the augmentation of the damage. It is still debated though whether the internet provider has to act only when the notification of the infringement is supported by sufficient evidence. Such an obligation to produce evidence regarding the intellectual property infringements is already established in the Act for the Protection of the Distributive Right via Network.⁴⁷

44 There are several treaties on this concept: *Li Hao* (李昊), On the Duty to Maintain Public Safety (交往安全义务论), Beijing, 2008. *Zhou Youjun* (周友军), Study on the Theory of the Duty to Maintain Public Safety (交往安全理论研究), Beijing, 2008.

45 *Wang Shengming*, 201-202.

46 *Wang Shengming*, 202.

47 (信息网络传播权保护条例), promulgated by the State Council on 18th May, 2006 and effective from 1st July, 2006.

IV. Defamation

1. Background

21 The number of defamation lawsuits has kept rapidly rising since the adoption of the reform and opening-up policy in China. The media frequently plays the role of defendant. Since the end of 1980s, five waves of defamation lawsuits against the media were counted with various groups such as public officials as the primary plaintiffs⁴⁸.

22 This rise can be attributed to several factors. First, it is the enactment of the GPCL in 1986 that has introduced for the first time legal redress for individuals against defamation.

Art. 101 "Citizens and legal persons enjoy the right of reputation. The human dignity of citizens is protected by law. It is prohibited to harm the reputation of a citizen or legal person by such means as insult or libel."

Art. 120 "If a citizen's right to a name, right of portrait, right of reputation or right of honor is infringed upon, he shall have the right to demand that the infringement be stopped, that his reputation be restored, that the effects of the infringement be eliminated and an apology be made. He may also claim damages."

If a legal person's right to a business name, right of reputation or right of honor is infringed upon, the provisions of the preceding paragraph shall apply."

23 As a result, courts have gained competence for defamation complaints. Shortly after the GPCL took into effect in 1987 the first wave of suing journalists began.⁴⁹

24 Second, the awareness of legal rights among Chinese population has grown significantly in the course of development of a modern legal system in China. Last but not least, Chinese media, once mouthpiece of the Communist Party, has gradually undergone a commercialization phase since the end of 1970s.⁵⁰ Because funding is no longer guaranteed by the government, Chinese media had to find ways to appeal to readers in order to promote sales and advertisement. Thus, the media began to publish more entertaining contents and critics on government activities.

⁴⁸ YANG Lixin (2011), 179.

⁴⁹ CHEN/ANG, 54; YANG Lixin (2011), 182.

⁵⁰ CHEN/ANG, 56.

Unsatisfied with the undesirable media exposure of private life or misconduct, entertainment stars and local officials response with legal proceedings against the media.

As the case in other countries, the most pressing issue Chinese legislature was 25 faced with in the process of deliberation of the LTL is how to strike a right balance between reputation, privacy and free expression. In the past, the SPC has issued a large number of replies to clarify the elements in establishing liability for defamation. Given the ambiguities related to defences (*infra* at 39 *et seqq.*), the LTL could have brought more clarification.

One hotly debated question was the one of whether media tort liability should be 26 codified as a special type of torts by the LTL.⁵¹ The LTL does not recognize the notion of media tort liability, nevertheless, the discussion in this regard still continues. The major argument rejecting the codification of media tort liability is that, on the one side, worldwide there is no such legislative precedent, on the other side, the classification of types of torts usually occurs based on the rights being infringed upon, not based on the type of tortfeasor.⁵²

2. Determination of Defamation

a. Criteria

In China, defamation is not explicitly listed as a particular type of torts and no 27 distinction is made between libel and slander. The plaintiff has to base a defamation claim on the general provisions of tort liability, namely art. 6 LTL and arts. 101 and 120 GPCL. In addition, over time the SPC has developed a great number of concrete rules in the form of judicial interpretations and replies clarifying the boundaries between defamation and legitimate free speech. According to the SPC in determining whether a conduct constitutes defamation, following criteria are to be taken into consideration: damage to the reputation of the infringed person, the illegality of the act of the tortfeasor, causation between the illegal act and the damage, and the existence of the tortfeasor's fault.

51 YANG Lixin (2011), 178.

52 ZHANG Xinbao, 184.

- 28** The SPC has listed three circumstances in which defamation may be determined:⁵³ (1) insulting or slanderous language that results in damage to the reputation of that person; (2) unauthorised disclosure or dissemination of private information that results in damage to the reputation of that person; (3) the content of a news report is serious erroneous, which results in damage to the reputation of that person. Accordingly, a defamatory conduct usually refers to an insulting or slanderous statement that damages another's reputation. A statement is insulting when words with negative connotation are used to appraise another person; a statement is slanderous when it is falsified for the purpose of impairing another's reputation. In judicial practice, falsehood is treated as a requirement to establish a defamation suit in China, since a falsified negative statement is per definition slanderous.
- 29** There are certainly cases where the information is true, but may cause humiliation anyway. Currently, in such a situation, the plaintiff is well advised to seek redress on the ground of legal protection for **privacy**. Previously, before privacy has yet been recognized in a statute, the SPC has granted the plaintiff legal protection in the case where an infringement upon privacy concurrently constitutes defamation.⁵⁴ However, this protection can only cover a narrow scope of interference into privacy, such as unauthorised revelation of sexual diseases.⁵⁵ Although the right to privacy is now codified in the LTL, its content remains still ambiguous. In legal literature, privacy is interpreted as the right to general peace and confidentiality of life,⁵⁶ which may further be divided into right to secrecy of personal data, right to be left alone, right to the commercialization of personal rights. It is to be pointed out that China has not yet established a comprehensive regime for personal data protection. The relevant provisions are scattered in various statutes. For instance, art. 62 LTL imposes a duty on medical institutions and their medical professionals to maintain the privacy and confidentiality of their patients and information thereon.

⁵³ Art. 7 of the Answers of the Supreme People's Court on Several Issues Relevant to the Trial of Cases Involving Rights to Reputation (最高人民法院关于审理名誉权案件若干问题的解答; thereafter: Answers to the Trial of Cases Involving Rights to Reputation)

⁵⁴ Art 3 (2) Interpretations on Mental Damages.

⁵⁵ Art. 8 of the Interpretations to Several Questions in the Trial of Cases Involving Rights to Reputation, promulgated on 31st August, 1998 and effective from 15th September, 1998. (最高人民法院关于审理名誉权案件若干问题的解释; thereafter: Interpretations to the Trial of Cases Involving Rights to Reputation).

⁵⁶ WANG Liming (2005), 563.

Legal entities with or without legal person status (*supra* Chapter 1 at 11 *et seqq.*) **30** are also entitled to bring defamation actions based on art. 14 AUCL. According to the SPC, critics or remarks on the quality of a product or service are not deemed defamatory if the content is basically true and not insulting.⁵⁷

To bring a defamation action, the plaintiff must establish that the statement refers to **31** himself, an aspect which may cause difficulties with respect to literary works. If a literary work contains only plots that are similar to information of a specific person without any description of the specific person, the reference to the plaintiff is usually denied. Where a literary work contains description of a real person or a real event, or where a literary work contains a description of the specific person without mentioning the real name of a specific person, but the relevant public is able to identify the person concerned, the reference to the plaintiff is deemed established.

A defamatory act is accomplished when the statement is **published**. Thus, the SPC **32** does not construe those cases as defamation where information that is capable of causing damage to the reputation of another is only circulated internally for the consultation by functionaries, because the reader circle is a closed one. If the information is circulated internally, but within a large range, for instance the range of a government agency, a social group, an academic institution, an enterprise or a social institution, such circulation is deemed a public dissemination.⁵⁸

c. Illegality

The conduct of the defendant must be illegal. Unlawfulness is denied when the **33** expression is justified. Examples include appraisals made by the employer regarding the the performance of an employee⁵⁹ or statement made in the course of a criminal charge or criminal complaint, as long as it is true.⁶⁰

d. Damage to the Reputation

It can be inferred from the SPC's interpretations that damage to the reputation of the **34** affected person is crucial to make a defamation case. Such damage may take the form of damage to the reputation itself of the plaintiff, or property loss such as loss

⁵⁷ Art. 9 of the Interpretations to the Trial of Cases Involving Rights to Reputation.

⁵⁸ Art. 2 of the Interpretations to the Trial of Cases Involving Rights to Reputation.

⁵⁹ Art. 4 of the Answers to the Trial of Cases Involving Rights to Reputation.

⁶⁰ Art. 5 of the Answers to the Trial of Cases Involving Rights to Reputation.

of jobs or promotion or mental distress, which is also compensable in money (*infra* at 45).

e. Fault

- 35** Liability for defamation is a fault-based liability. In China, the question of how to establish the criterion of fault is still debatable (*supra* Chapter 10 at 32). Generally speaking, in defamation lawsuits fault includes both intent and negligence, while negligence is the more prevalent form. In judging the element of fault, both the subjective motive and the objective standard of care are to be taken into consideration. In particular with regard to the media, which bears a duty of examination as to the truthfulness of information, serious falsehood of the material is regarded as an indicator of fault,⁶¹ when the media itself is the author or deemed the author. Some even assume that the media's fault is in this case not rebuttable, while the mainstream opinion believes that the media may exculpate itself when it is capable of proving that the falsehood is caused by factors not attributable to the media, such as fault of a third party and contributory negligence of the plaintiff.⁶²
- 36** In terms of the editor's/publisher's liability for the work of another, fault may be determined according to the rule established by the SPC, which requires an editor/publisher to publish an announcement to remove the negative impact or take any other remedial measures after a work it edited/published has been determined by a court to be infringing or after it is informed by the affected person that the work is obviously infringing. If the editor/publisher refuses to take such measures or continues to publish the infringing work, the pertinent act is deemed as an act of infringement,⁶³ because the editor/publisher clearly acts at fault. To a certain degree, this rule lowers the duty of care in that the media is not required to investigate whether an article of another is infringing prior to its publication, as opposed to work created by the media itself.

f. Liability of Editor, Publisher and Informant

- 37** In a defamation case arising from news reports or other works, the plaintiff is allowed to choose to sue either the author, or the editor/publisher or both. If the

⁶¹ Art. 9 of the Interpretations to the Trial of Cases Involving Rights to Reputation.

⁶² *Xu Xun et al*, 52.

⁶³ Art. 9 of the Answers to the Trial of Cases Involving Rights to Reputation.

author is an employee of the media, then the plaintiff may only sue the editor/publisher.⁶⁴ With regard to publication in the Internet, it is still controversial whether websites qualify as publishers. The liability of editors/publishers for republication of a published work is milder than that for the first publication of a work. The plaintiff may only claim counterstatement and cessation of publication. Recovery for monetary loss is instead unavailable.⁶⁵

An informant is liable for defamation in case where he volunteered to provide the source which results in the damage to another's reputation. Should a news agency approach an informant and publish material gained from an interview with him without the corresponding consent of the informant, the provision of the source is not regarded as defamation. Where the informant gives consent to or tolerates the publication, the provision of the source may be established as defamation if the reputation of the affected is harmed.⁶⁶

g. Defences

Lacking explicit provisions, the issue of defences specifically applicable to defamation by media is still of great uncertainty. Following doctrines in Western legal systems, commentators have also developed different rules for China.⁶⁷ Those having been adopted by courts include:⁶⁸

(1) **Truth** except when the creditworthiness or privacy is affected or the language is insulting. With respect to the media, the truth requirement is confined to truth at the time of first reporting, as long as the final truth is timely and accurately revealed, which is able to rectify the previous error unknown at the time of first reporting.⁶⁹

(2) **Fair comment.** In Western countries, distinction is made between **facts** and **opinions** in defamation actions. In China this distinction is also relevant. In this regard, the SPC has elaborated the following rules: where an article contains basically true information and is not insulting to the personality of another person, the creation or publication of the article is not deemed as defamation. Where an article contains basically true information and is insulting to the personality of

⁶⁴ Art. 6 of the Answers to the Trial of Cases Involving Rights to Reputation.
⁶⁵ Art. 3 of the Interpretations to the Trial of Cases Involving Rights to Reputation.
⁶⁶ Art. 7 of the Interpretations to the Trial of Cases Involving Rights to Reputation.
⁶⁷ YANG Lixin, 1-17.
⁶⁸ Yu Lijiang, 104.
⁶⁹ Yu Lijiang, 104-105.

another person, and causes harm to the reputation of that person, the creation or publication of the article is deemed as defamation. Where the basic contents of an article are erroneous, causing harm to the reputation of another person, the creation or publication of the article is deemed defamatory.⁷⁰ A fair comment requires that the opinion must be honest regardless of the motive of the commentator and that the matter must be of public interest. Disputable is the question of whether this defence still applies when the underlying facts prove to be erroneous. The mainstream view holds that, as long as the facts relied by the commentator are used in good faith, the defence is applicable, because it is an unreasonable burden to require a commentator first to verify the authenticity of the news he is about to comment.⁷¹

- 42 (3) Public figure.** It is generally acknowledged that public figures include officials and other prominent persons such as sport and entertainment stars and social activists. The most controversial issue involving public figure is whether to adopt the “actual malice” doctrine in the US law for the sake of free expression.⁷² So far, judicial practice still declines the employment of this doctrine and instead accepts the defence of public figure only when the media exposure remains in an endurable scope, which is confined to information of public interest.⁷³
- 43 (4) Authoritative source.**⁷⁴ This defence operates to exclude defamation when a media report is written based on documents made and published by a government agency within its competence or public act implemented by a government agency and its content is objective and accurate. If the media report distorts the facts or the government document or the official act has been publicly rectified and the media refuses to publish a counterstatement, then such report is deemed defamatory.

h. Defamation Lawsuits of Deceased

- 44** Although reputation is considered a personal right and should cease to exist with the death of a natural person pursuant to art. 9 GPCL, as early as 1989 the SPC confirmed in a reply to a lower court in a defamation case brought by the mother of a

⁷⁰ Art. 8 of the Answers to the Trial of Cases Involving Rights to Reputation

⁷¹ *Yu Lijiang*, 105.

⁷² *Yu Lijiang*, 107. This doctrine requires the plaintiff to establish the defendant’s knowledge of the falsehood of the published information in order to win a libel case.

⁷³ *Yu Lijiang*, 107.

⁷⁴ Art. 6 of the Interpretations to the Trial of Cases Involving Rights to Reputation.

deceased actress that the reputation of a deceased should be protected.⁷⁵ In case where a deceased's reputation is harmed, any of the deceased's close relatives is entitled to sue before a competent court. The close relatives include the spouse, parents, children, siblings, grandparents and grandchildren.⁷⁶ It means that the reputation of a deceased person is practically protected for the life span of the last deceased close relative. There is no agreement as to whether the prosecution office is allowed to bring defamation action after all close relatives passed away.⁷⁷ A problem still remains: the SPC deliberately did not specify the order of the standing of the close relatives to bring defamation action.⁷⁸

i. Relief

In a defamation case, the plaintiff is entitled to claim recovery for monetary loss and mental distress. The amount of mental damages is determined based on the degree of the infringer's fault, the facts of infringement, and the consequences of the mental distress caused to the victim, etc.⁷⁹ If the reputation of an enterprise is infringed, the monetary loss is calculated based on the scope of termination of contracts or return of goods by the plaintiff's customers as a result of the defamation.⁸⁰ **45**

The plaintiff also has a claim to require the wrongdoer to cease infringement, rehabilitate reputation, eliminate impact and make an apology. For rehabilitation of reputation, elimination of impact or offering of apology, written or oral form may be adopted and the relevant contents are to be examined by the court in advance. The scope of rehabilitation of reputation and elimination of impact generally corresponds to the scope of adverse effect of the infringement. Where an infringer refuses to rehabilitate reputation and eliminate the impact on the other party, the court may publicize the main contents and relevant information of the judgment through a **46**

⁷⁵ (最高人民法院于自然人死亡后,其名誉受到侵犯,其直系亲属是否有权提起诉讼问题的函) (Reply of the SPC on the Question of Whether the Relatives of a Deceased Natural Person is Entitled to Sue if Its Reputation is Infringement dated of 12th April, 1989) ; 最高人民法院于死亡人的名誉权应依法保护的复函 (Reply of the SPC on the Question of Whether the Right to Reputation of a Deceased Person Should Be Legally Protected dated of 12th April, 1989).

⁷⁶ Art. 5 of the Answers to the Trial of Cases Involving Rights to Reputation.

⁷⁷ http://www.npc.gov.cn/huiyi/lfzt/qqzrfca/2008-12/21/content_1462861.htm.

⁷⁸ http://www.npc.gov.cn/huiyi/lfzt/qqzrfca/2008-12/21/content_1462861.htm.

⁷⁹ Art. 10 of the Answers to the Trial of Cases Involving Rights to Reputation.

⁸⁰ Art. 10 of the Interpretations to the Trial of Cases Involving Rights to Reputation.

public announcement or publication in newspaper, etc. The relevant expenses are to be borne by the defendant.⁸¹

j. Procedural Aspects

- 47** In a defamation case, the plaintiff is allowed to sue either at the place of infringement or the place of the defendant's domicile according to art. 29 of the Civil Procedure Law. The place of infringement includes the place where the infringement is committed, the place where the consequences of infringement occur⁸² and the place of the plaintiff's domicile.⁸³

V. Product Liability

1. Background

- 48** The Chinese product liability regime began to evolve in the late 80s.⁸⁴ Prior to 1985, product liability was entirely unknown in legal literature. A series of accidents caused by defect products, such as explosion of beer bottles, leak of gas boiler, deformation caused by defect cosmetics in the mid 80s, gave rise to adopting the concept of product liability from the EU and US in the GPCL. Following the GPCL, the State Council enacted the Regulations regarding the Liability for the Quality of Industrial Products⁸⁵ on 5th April, 1986. However, both statutes failed to curb the deterioration of product quality in China. In response to that, the Product Quality Law was promulgated in 1993 and amended 2000 to strengthen sanctions against manufacturing and distribution of products of inferior quality. To-date, China still has difficulties in dealing with product quality problems in almost all business sectors, in particular where a large number of people are affected by a single product as the case with contaminated milk powder causing more than 294,000 babies poisoned.⁸⁶ These victims were often barred from bringing individual actions against the producers and had to put up with lump-sum compensation at a rather low level. It

⁸¹ Art. 11 of the Answers to the Trial of Cases Involving Rights to Reputation.

⁸² Art. 4 of the Answers to the Trial of Cases Involving Rights to Reputation.

⁸³ Art. 1 of the Interpretations to the Trial of Cases Involving Rights to Reputation.

⁸⁴ For a detailed account of historical evolution of product liability regime in China, *LIANG Huixing*, 38-40.

⁸⁵ 工业产品质量责任条例, promulgated on 5th April, 1986 and effective from 1st, July 1986.

⁸⁶ Formula for disaster - The politics of an unconscionable delay, *Economist* of 18th September, 2008; Redress by relocation - Victims of tainted Chinese goods seek compensation in Hong Kong, *Economist* of 3rd June, 2010.

has not become a common practice for manufacturers to purchase insurance for product liability.

2. Nature of Liability

The Chinese product liability regime in a broader sense consists of arts. 41-47 LTL, **49** art. 41-46 of the Product Quality Law (PQL) and art. 122 GPCL. In a whole, the LTL has only incorporated the existing norms in a simplified form and introduced two new norms governing the duty to call back and punitive damages (*infra* at 53-54). Strictly speaking, product liability only refers to liability for bodily injury and property loss caused by a defect product that is other than the product itself. Therefore, product liability in a narrower sense in China is a **no-fault liability**. Of course, the plaintiff is entitled to recover loss also on a contractual basis if a contract exists between the plaintiff and the defendant and this contract is breached by the delivery of a defective product. But this does no longer constitute product liability and is therefore not discussed here. Equally excluded is tort liability for damage caused by wrongful transportation or storage of a product. This is nothing more than an ordinary fault-based liability.

3. Major Aspects

a. Defect

Unlike the PQL, the LTL does neither define the important terms “product” and **50** “defect” nor does it regulate the exclusion of liability. In this regard, it is to assume that the rules of PQL are still valid⁸⁷, although the existing rules are not unproblematic. According to art. 46 PQL a product is defective, if it either poses an unreasonable risk to human body or another’s property or fails to meet official or sector-specific safety standards. This is – according to the mainstream opinion – not to be interpreted in the way that compliance with these standards rules out the existence of a product defect, for these standards frequently fail to reflect the most up-to-date level of safety.⁸⁸ Chinese law does not draw a distinction between manufacturing defect, design defect and warning defect in tort statutes, but in literature and case law these terms are used from time to time. In particular, art. 27

⁸⁷ WANG Shengming, 224-225.

⁸⁸ XI Xiaoming, 302.

PQL imposes a duty on the manufacturer to warn if improper use of the product is likely to cause the product itself to be damaged or to endanger personal safety and/or the safety of property. "Products" are defined in the PQL as manufactured or processed goods intended for sale (art. 2 PQL). Primary agricultural products, non-processed products and raw materials do not fall within the definition. Buildings are also explicitly excluded from the scope of the PQL. However, parts of buildings or construction materials are still subject to product liability.

b. Manufacturer and Distributor

51 Although product liability according to the PQL was based on the Directive (EC) 1985/374 and US law, Chinese law is nevertheless different. Manufacturers and distributors are still liable as non-genuine joint and several debtors for defect products (*supra* Chapter 10 at 26). However, the term "manufacturer" is neither defined, nor is the liability for defective components of a product addressed. In case law, manufacturers are construed to also include those who present themselves as the product's manufacturers by affixing their names, titles, trademarks or other distinguishable marks to the defective products.⁸⁹ Where it cannot be established which of several possible producers manufactured the defective product, the joint danger rule stipulated in art. 10 LTL applies, which imposes a joint and several liability on all manufacturers.

c. Liability Scope

52 First, the victim is entitled to recover physical harm and property loss, irrespective of whether the product is designated for private use and consumption or commercial use. Lost profit can also be claimed within product liability where it is severe.⁹⁰ However, in the case of damage to property, product liability comes according to art. 41 PQL only into action if an object other than the defective product itself is affected. The damage to the product itself is deemed as a pure economic loss (*supra* Chapter 11 at 13) and can be recovered based on the contract between the buyer and the seller.⁹¹ This restriction is left out in art. 41 LTL, which raises the question of

⁸⁹ Reply of the SPC to the Question of Whether the Victim May Sue the Trademark Owner in a Product Liability Case (最高人民法院关于产品侵权案件的受害人能否以产品的商标所有人为被告提起民事诉讼的批复), promulgated on and effective from 11th July, 2002.

⁹⁰ GAO Shengping, 110.

⁹¹ LIANG Huixing, 43.

whether the injured buyer may now recover all the loss he suffered including the damage to the product itself in a single proceeding. On the one hand, art. 41 PQL is able to derogate art. 41 LTL by virtue of art. 5 LTL (*supra* Chapter 10 at 7-10) because art. 41 PQL may be deemed as a special regulation in the sense of art. 5 LTL. This way of reading would implicate that the omission of the restriction of product liability in art. 41 LTL, thereby causing a deviation between art. 41 LTL and art. 41 PQL, was actually unintended and one might assume the extent of product liability remains the same. On the other hand, in the commentary edited by the SCNPC it is alleged that, since the victim will be in a better position to recover loss if he may sue for compensation for all the damage he suffered in a single action, art. 41 LTL is to be construed to also cover damage to the product itself.⁹² Although beyond that there is no clear indication that it was legislator's will to make a corresponding change, leading scholars tend to follow the opinion expressed in the above-mentioned commentary.⁹³

Second, manufacturers and distributors are obliged to warn and call back, if a **53** product defect is discovered after being placed in the market. Recall is not a new legal concept in China. A duty to recall motor vehicles in case of product defect has been introduced in 2004 by an order of the PRC Administration of Quality Supervision, Inspection and Quarantine. The LTL has extended this duty to all products. A corresponding regulation concerning the recall of deficient products is currently in legislative deliberation process.

Third, the victim is allowed to claim punitive damages in case where manufacturers **54** and/or distributors have continued production and distribution despite their awareness of the product defect that has resulted in death or grave bodily damage of the victim. This claim to punitive damages has been asserted quite frequently, which has also led to controversy among commentators. Opinions are still divided over punitive damages in China. Prominent proponents can be found on both sides. Punitive damages are rejected, because according to civil law theories compensation is to serve economic compensation for the illegally inflicted damage

⁹² GAO Shengping, 108-109; WANG Shengming, 226.

⁹³ GAO Shengping, 108-109; WANG Shengming, 226; WANG Liming (2011), 47, 53-54, is of the opinion that the victim is allowed to recovery all the loss if the loss does not only consist of the damage to the product itself in a single proceeding; if the damage to the product is the sole damage, then the victim is only entitled to a contract cause of action. This is because in the latter case, the damage is a pure economic damage.

and not the sanctioning of it. The recognition of punitive damages was justified with the preventive and sanctioning purpose of liability law, especially in mass liability cases.⁹⁴

d. Procedural Aspects

55 To bring a product liability case, the plaintiff must prove that the product was defective, damage has occurred and the defect caused damage. The claim to compensation is time-barred two years after the aggrieved party takes note of the damage or should have taken note of it. According to art. 45 PQL the claim expires ten years after the product is sold to the first consumer.

e. Defences

56 The defences specifically available to the defendant in a product liability case are set out in art. 41 of the PQL and include: (1) the product has not been put into circulation; (2) the defect did not exist when the product was put into circulation; and (3) the product's defect could not be discovered according to the state of the art at the time when the product was put into circulation. In addition, the defendant may also invoke the general defences codified in the LTL such as comparative fault of the victim or fault of a third party.

VI. Liability for Accidents Involving Motor Vehicles

1. Background

57 Accounting for about one third up to half of all adjudicated tort cases, liability for accidents involving motor vehicles heads the list of all tort cases.⁹⁵ The reason behind this is a fast growing car market and the unestablished consciousness of compliance with traffic rules in China. In November 2012 the SPC enacted a judicial interpretation dedicated to liability for motor vehicles and further specified rules of applying the relevant provisions in the LTL.⁹⁶

⁹⁴ *Xi Xiaoming*, 341.

⁹⁵ *Wang Shengming*, 246.

⁹⁶ Interpretation of the Supreme People's Court on Issues Concerning the Application of Law in the Trial of Cases Involving Traffic Accidents (最高人民法院关于审理道路交通事故损害赔偿案件适用法律若干问题的解释) (Hereinafter: Interpretation on Liability of Traffic Accidents), promulgated on 27th November, 2012, effective on 21st December, 2012.

2. Nature of Liability

The regime for motor vehicles' liability consists of the Chapter VI of the LTL and the 58 Road Traffic Safety Law (RTSL)⁹⁷. The attribution principle in this area is believed to be diversified and still subject to debate in legal writings. Being the basic rule of liability for accidents involving motor vehicles, art. 48 LTL states that *"For damage caused by motor vehicles in traffic accidents, liability to pay compensation shall be determined in accordance with the relevant provisions of the Law on Road Traffic Safety"* and thereby refers to the RTSL without specifying which concrete provision is meant. According to the common construction in literature and practice, it should be art. 76 RTSL.

According to this provision, the insurance covers the claim for compensation up to 59 the cap of the mandatory motorist liability insurance.⁹⁸ For claims exceeding this cap, the law differentiates between two cases, that is to say, between an accident involving motor vehicles only and one involving motor vehicles as well as other non-motorized road users. In the former case, liability is imposed upon the party acting at fault. If both parties were at fault, the liability is split between them according to their own fault. It can be inferred from this provision that in this case, motor vehicle owner's liability is **fault-based**. If neither party is at fault for the accident, the loss is to be distributed among them by taking into account all circumstances in pursuance with art. 24 LTL. In the latter case, the motorist is principally liable. However, liability reduction is permissible if the motorist is able to prove that the other road user has also contributed to the damage. If the motorist is not responsible at all, liability is limited to 10% of damage. In this case, the motor vehicle owner's liability is construed either as a **liability based on presumed fault** or a **no-fault liability**.⁹⁹ As the motorist's fault is actually relevant, it is more accurate to call the motorist's liability a liability based on presumed fault.

⁹⁷ (道路交通安全法), promulgated by SCNPC on 28th October, 2003 and effective from 1st May, 2004, last revised on 22nd April, 2011.

⁹⁸ According to the provisions of the insurance supervision authority the cap for compensation for death and disability cases is RMB 110,000, for medical treatment is RMB 10,000 and for damage to property RMB 2,000 where the owner of the motor vehicle is at fault. Where the owner of the motor vehicle is not at fault, the cap for compensation for death and disability cases is RMB 11,000, for medical treatment RMB 1,000 and for damage to property RMB 100. This standard is effective from 1st February, 2008.

⁹⁹ KOZIOL/ZHU, 353; YANG Lixin (2008), 111-112.

60 The LTL itself does not offer a definition for motorized vehicle (机动车) and non-motorized vehicle (非机动车). These terms are instead defined in art. 119 RTSL.¹⁰⁰ Nonetheless, it is still disputable as to the criteria in distinguishing the two types of vehicles. Some argue it should be the purpose and risk of the vehicle. Thus, an e-bike is normally a non-motorized vehicle. When the maximum speed and weight of an e-bike exceed the limitations imposed on non-motorized vehicles, such an e-bike is deemed as a motorized vehicle.¹⁰¹

3. Recovery from the Insurance

61 The insurance liability stipulated in art. 76 RTSL is a statutory liability with the result that the aggrieved party can directly recover compensation from the insurer.¹⁰² With regard to the terminology, one has to point out that Chinese law does not use the term “motor vehicle owner” for the person being liable to pay compensation, but rather the term “party related to the motor vehicle” (机动车一方). Also here no definition is provided for this term. Because insurance liability is a statutory liability, the insurances of the involved motor vehicles are not liable proportionally according to the fault of the respective drivers within the amount insured, but rather equally in the case where the damage is caused by two or more motor vehicles.¹⁰³ If a car is sold and already handed over, while the transfer of ownership has not yet been registered, the insurance coverage remains the same within the amount insured (*infra* at 64) as the insurance coverage is not connected with the insured, but rather with the motor vehicle.¹⁰⁴ On 1st September, 2006, mandatory liability insurance for motor vehicles was implemented with the Act of Compulsory Liability Insurance for Motor Vehicles¹⁰⁵ entering into force in China.

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¹⁰⁰ Art. 119 “(3) “Motor vehicles” mean the wheeled vehicles driven or drawn by power sets on roads for carrying people, for transporting cargoes, or for special engineering operations.

(4) “Non-motor vehicles” mean such means of transport as are driven or drawn by man or animal on roads, and the motor wheelchairs for the disabled and electrically operated bicycles which are installed with power sets but the designed maximum speed per hour, the light quality and the external size of which are in conformity with the relevant standards of the State..” – Translation from Westlaw China.

¹⁰¹ *Liu Jiaan*, 13-14.

¹⁰² *Xi Xiaoming*, 349; Art. 16 of the Interpretation on Liability of Traffic Accidents.

¹⁰³ *Xi Xiaoming*, 353.

¹⁰⁴ *Xi Xiaoming*, 354.

¹⁰⁵ 机动车交通事故责任强制保险条例, promulgated on 21th March 2006 and last revised on 17th December 2012.

Some commentators argue that the liability reduction or exemption should only be granted, if the motorist can prove that the other road user acted deliberately or grossly negligent to hurt himself.¹⁰⁶ Furthermore, comparative negligence of the other road user should only be taken into account with regard to the amount exceeding the liability cap. Below the cap, comparative negligence of the other road user is irrelevant. Following previous discussion on liability reduction/exemption (*supra* Chapter 10 at 67), it is to assume that in any event liability exemption is permissible only when the intentional action of the victim is the sole cause for the damage.

4. Liability for Rented Vehicles

Arts. 49-53 LTL differ from the aforementioned basic rule. According to art. 49 LTL, **63** the insurer assumes the obligation to compensation when a rented or borrowed car is involved in an accident only if the damage is attributable to the actual user's fault. In legal literature, however, article 49 LTL is construed in the way that insurer will always be held liable, regardless of the actual user's fault.¹⁰⁷ The actual user is liable for damage exceeding the insurance cap. The owner is correspondingly liable if he was at fault in the course of making the car available to the actual user. Even so, it remains unclear what is meant with the term "corresponding liability of the owner" and whether this is a supplementary liability (*supra* Chapter 10 at 22 *et seq.*) or not. The recognition of the complementary nature of the liability is preferable as the victim should not be allowed to enrich himself as a result of cumulative payment of compensation above the actual damage. The fault of an owner is established, if he has not checked the actual user's fitness to drive adequately or if he has not taken out mandatory liability insurance or if he has not kept the motor vehicle in good repair.¹⁰⁸ Art. 49 is also applicable to the case where the use of the car by the actual driver is done without its owner's consent, but did not constitute itself a crime such as theft or robbery.¹⁰⁹

¹⁰⁶ Xi Xiaoming, 350 *et seq.*

¹⁰⁷ Xi Xiaoming, 361.

¹⁰⁸ Xi Xiaoming, 362.

¹⁰⁹ Art. 2 of the Interpretation on Liability of Traffic Accidents.

5. Liability for Sold Vehicles

64 If a car is sold and already handed over, while the transfer of ownership has not yet been registered, the insurer steps in within the sum insured according to art. 50 LTL, if the driver of the motor vehicle is to be blamed for the misconduct. The purchaser is liable for the remaining difference between the damage and the sum insured. According to art. 24 RRL, the registration in motor vehicle register is not a mandatory prerequisite for the transfer of ownership of a motor vehicle, but has only effect against a third party. This means that upon delivery, the acquirer has already become the owner of the vehicle, he just cannot hold his property against a bona fide third party (*infra* Chapter 14 at 14-15). Since the injured has no interest *in rem* in the vehicle, he should not be considered as a bona fide third party, so for him the acquirer is the legal owner, even if a person other than the owner is recorded in the register. Art. 50 LTL confirmed an earlier reply of the SPC, according to which the original owner is no longer liable for claims after the handover.¹¹⁰ In the case of a chain of sale of the same car, the last purchaser to whom the car has been handed over is deemed as its owner.¹¹¹

6. Liability for Stolen, Converted, Looted, Unidentified or Uninsured Vehicles

65 Caused a stolen, converted or looted vehicle damages, the thief, converter or looter is liable according to art. 52 LTL. The insurance has a duty to advance the medical and rescue expenses within the coverage according to art. 22 of the "Act of Compulsory Liability Insurance for Motor Vehicles" and may claim reimbursement of expenses from the actual tortfeasor. In case where the driver commits after an accident hit-and-run, the insurance covers the liability according to art. 53 within the coverage; in case where an accident is caused by an uninsured or unidentified motor vehicle, the medical emergency expenses and funeral expenses will be advanced by the social welfare fund designated for traffic accidents. The welfare fund then has a claim to indemnification against the tortfeasor.

¹¹⁰ Reply of the SPC on the Inquiry Regarding the Question of Whether the Original Owner is Liable for the Damage Caused by a Motor Vehicle in the Case of Multiple Sales of the Vehicle without Conducting Transfer of Owner's Name in the Vehicle Register (最高人民法院关于连环购车未办理过户手续,原车主是否对机动车发生交通事故致人损害承担责任的请示的批复) dated of 31st December, 2001.

¹¹¹ Art. 4 of the Interpretation on Liability of Traffic Accidents.

7. Liability for Unsuitable Vehicles

Art. 51 LTL governs the liability for damage caused by a motor vehicle that is due to be scrapped or is assembled with major parts from scrapped cars such as motor, steering wheel, gear transmission, front and rear axle and frame.¹¹² The manufacture and/or sale of such vehicles are a widespread illegal practice in China. For the damage caused by such vehicles, the seller and the purchaser are liable as joint debtors. Whether a vehicle is ready for scrapping will be assessed according to the applicable regulations regarding the scrapping of cars, motorcycles and agricultural vehicles.

VII. Liability for Medical Damage

1. Background

Liability for medical damage is one of the most controversial issues in the codification process of the LTL. In China, the relationship between physicians and patients has long been overstrained. On the one hand, patients used to have high procedural obstacles to overcome in order to sue physicians for their errors and the amount of compensation was low. On the other hand, physicians are often threatened with physical violence by disgruntled families and relatives of patients, when the outcome of the treatment is not satisfactory in their perception.¹¹³ The deficient legal channels and the prevalence of violent incidents are in fact interrelated. These conflicts of interests are to a certain extent a consequence of the widespread commercialization of health care sector in China, fuelled by populist reporting. As physician's salary is low, it is common for hospitals and physicians to enhance earnings by levying commissions on prescriptions and ordering sometimes unnecessary medical examinations, which merits dissatisfaction among patients. Prior to the enactment of the LTL, the legal regime governing medical damage has been criticized for the evolution of a bifurcated compensation system, which makes a distinction between two types of liability for medical damage: medical accident (医

¹¹² The term of assembled cars is defined in the Measures on Recycling of Scrapped Cars (报废汽车回收管理办法), promulgated by the State Council on 16th June, 2001 and effective from 16th June, 2001.

¹¹³ <http://www.bloomberg.com/news/2012-03-29/violent-crimes-in-china-s-hospitals-spread-happiness.html>.

疗事故) and other medical damage (医疗损害). The former is governed by the Regulation on the Handling of Medical Accidents (医疗事故处理办法) issued by the State Council in 2002 (State Council Regulation), while the latter falls within the scope of application of art. 106 para. 2 GPCL (*supra* Chapter 11 at 4). In the legal framework created by the State Council Regulation, not only are the elements to establish liability much harder to prove, damages awards are also significantly lower than that those rendered on the basis of the GPCL. In particular, to make a medical malpractice case under the older regime, the plaintiff has to first procure an expert opinion proving that a medical malpractice indeed took place. Only local commissions for the appraisal of medical accidents, subordinating to the National Association of Medical Science (NAMS), are empowered by the State Council Regulation to examine the existence of medical accidents. The experts are usually biased, given the fact that members of those local NAMS-branches often know each other. The most astonishing fact is that if a medical error failed to be determined as a medical accident, the patient was allowed to invoke legal protection provided by the GPCL and may often recover more than under the regime of the State Council Regulation.

2. Nature of Liability

69 Chapter VII of the LTL is construed by a leading tort law scholar having introduced three liability attribution principles for medical institutions: fault-based liability for medical technical errors (arts. 54, 58), liability on presumed fault for medical-ethical errors (arts. 55-56) and no-fault liability for defect medical products (art. 59). However, this distinction, albeit may also be inferred from the explanation of the LTL's drafts, is not entirely indisputable. Above all, pure medical-ethical errors that merely lie in the breach of ethical rules are rare, in most cases medical-ethical errors are co-mingled with medical-technical errors and both of them contribute to the damage.¹¹⁴ This distinction has been criticized in that it neither makes it easier for patients to bring a medical malpractice action nor make it easier for courts to adjudicate such cases by separating them from each other.¹¹⁵

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¹¹⁴ WANG Cheng, 119.

¹¹⁵ WANG Cheng, 117-118.

According to art. 54 LTL a medical institution (医疗机构) is liable for damage caused to a patient in the course of medical treatment only if itself or its medical staff (医务人员) had made an error in treatment. Thus, the liability of hospitals and physicians is made less strict compared to the previous liability for presumed fault introduced by art. 4 (1) No. 8 of "Some Provisions on Evidence in Civil Procedure"¹¹⁶. Previously, the burden of proof for the plaintiff to make a malpractice case is reversed twice: It is not the plaintiff who has to prove that a medical error exists and the damage is caused by the wrongful treatment, but the medical institution that has to prove that no error took place and no causal link exists between the treatment and the damage. Thanks to this shift in burden of proof, it became much easier for patients to make a medical malpractice case. In response to the risks of abuse by patients, physicians preferred conservative treatments and extensive examinations, sometimes they even denied treatments. Only against this background, arts. 63, 64 LTL are understandable. Art. 63 prohibits unnecessary examinations and art. 64 the disturbance of the organization of medical facilities and the normal work and normal life of physicians by patients. From a purely legal perspective, these regulations are self-evident that they did not suppose to be explicitly addressed in a statute.

According to art. 54 LTL the defendant in medical negligence cases is always the 71 involved medical facility. This also corresponds to the employer's liability established in art. 34 LTL (*supra* at 4), as medical practitioners in China usually work in an employment relationship with medical facilities. The same goes for the claim of medical facilities to contribution against the physicians acting at fault. As art. 54 LTL does not provide a definition for medical institution and medical staff, its scope of application still needs to be clarified. In particular, it is to clarify whether this provision is applicable to independently practicing physicians.

3. Determination of Fault

To judge where there is any misconduct of the medical staff, the general level of 72 treatment at the time of the treatment is crucial according to art. 57 LTL. In legal literature it has been proposed that the local gap between rural and urban areas and between specialists and generalists should be taken into account when determining

¹¹⁶ (最高人民法院关于民事诉讼证据的若干规定), promulgated by the SPC on 21st December, 2001 and effective from 1st April, 2002, last revised on 31st December, 2008.

the general level of treatment.¹¹⁷ The lawmaker did not incorporate these factors into the LTL because it would have enabled medical institutions to always argue that their local level of treatment is lower than the average level and thereby to easily invoke exculpation.¹¹⁸

- 73** To recover medical damage under the new legal regime established by the LTL, the plaintiff must prove the existence of an error and causation between the error and damage. In order to discharge the burden of proof, the patient is entitled to require access to and duplicate his medical treatment records (art. 61 para. 2 LTL). Nonetheless, the fault-based liability regime has created a significant hurdle for patients to win a medical damage case. Lacking expertise, patients have to rely on expert opinions to establish the existence of a medical error and advance the expenses associated with furnishing the appraisal.
- 74** To alleviate the plaintiff's burden of proof, fault of medical institutions is statutorily presumed in the cases stipulated in art. 58 LTL, which include: (1) violation of laws, administrative regulations, statutes and other relevant regulations; (2) hiding or denying the release of the patient records related to the dispute; (3) falsifying, modifying or destroying the patient records. However, it is still controversial whether this presumption is rebuttable or irrebuttable and whether this presumption of fault provides a substantial assistance for the plaintiff to discharge his burden of proof. Arguing from the legislative history and the wording, a minority opinion views art. 58 LTL as an irrebuttable presumption of fault¹¹⁹, while the majority considers the presumption is rebuttable, otherwise the lawmaker should have explicitly used the term "irrebuttable presumption" (认定).
- 75** Apart from this controversy, it is reasoned by commentators that the rule on presumption of fault is of only limited assistance to patients.¹²⁰ The reason is that to invoke presumption of fault stipulated in art. 58 LTL, the plaintiff must first prove the existence of one of the three scenarios and it is hard to establish the occurrence of the first and the third scenario. For instance, without consulting medical experts, the plaintiff is often unable to demonstrate that the defendant has violated medical regulations. In contrast, under the regime established by "Some Provisions on

¹¹⁷ *Xi Xiaoming*, 409 *et seq.*

¹¹⁸ *LIANG Huixing*, 38.

¹¹⁹ *LIANG Huixing*, 38-39.

¹²⁰ *WANG Cheng*, 119-121.

Evidence in Civil Procedure" fault is presumed as soon as the plaintiff shows the existence of damage.¹²¹

4. Informed Consent

Art. 55 LTL governs the liability for damage caused in the case where an effective **76** consent of the patient lacks. The **medical staff**, not only the physician, has the duty to inform the patient about the circumstances of the illness and the medical treatments and the duty to explain the risks of treatment and the possibility of alternative treatments, the need for special examinations and treatments, and to obtain written consent of the patient. In exceptional circumstances, a close relative of the patient is allowed to give an informed consent as his representative, if it is inappropriate to inform the patient about the risks, for example, because the health may deteriorate due to the negative message. In an emergency case, such as to save the life of the patient, the duty to secure consent from the patient or his close relatives is waived, if it is impossible. This impossibility also includes the situation in which the close relative refused to consent, but the refusal is not justifiable from an objective view.¹²² With the approval of the person responsible or the authorised person in charge of the medical institution such as the medical superintendent of a department, the appropriate treatment can be applied. The crucial question with art. 55 LTL is whether the breach of duty alone can justify a claim for compensation or a medical malpractice is required in addition to the breach of duty. According to literature and case law mental damage as a result of intervention, where no effective consent existed, is sufficient for the plaintiff to bring a compensation claim even if there is no medical error.¹²³

5. Liability for Drugs

According to art. 59 LTL, hospitals are liable for defects in drugs, disinfectant **77** preparations, medical devices and defective blood products like a seller in the product liability cases. So the patient can always recover from the medical establishment, even if he is not responsible for the product defect. After paying the

¹²¹ *WANG Cheng*, 121.

¹²² *Xi Xiaoming*, 404 et seq.

¹²³ *Xi XIAOMING*, 399; *Department of the LAC for Civil Law*, 766 et seq.

damages, the medical institution may claim reimbursement from the manufacturer or the provider of the defective products.

6. Defences

- 78** Art. 60 LTL sets out the exclusions of liability. These include the refusal of cooperation in treatment by the patient or his close family members, compliance with the appropriate treatment required for the rescue of patients at risk and in the event that there were only minor chances of cure due to the medical treatment level at the time of treatment.

VIII. Environmental Liability

1. Background

- 79** The Chinese environmental liability regime consists of the Chapter IIIV of the LTL, the GPCL and a large number of relevant rules in specific environmental laws protecting ocean, air, water, forest, fishery, soil, mineral resources and wild animals etc. Chapter IIIV of the LTL deals exclusively with environmental liability, although this chapter only contains four rather simply worded provisions (arts. 65-68). The dedication of an extra chapter serves to illustrate the importance of this subject. According to media reports more than 1,000 cases of environmental liability are adjudicated in court across the country per year.¹²⁴ Considering Chinese courts are still very careful in dealing with environmental damage for the fear of causing social dissatisfaction, many cases are actually solved through administrative channels, so that the exact number of environmental torts cases remains obscure. Given the magnitude of environmental pollution, ecological deterioration and environmental accidents caused by the rapid economic development in China, it is understandable that Chinese legislature was expected to address this issue in the newly enacted LTL. These norms in the LTL are admittedly insufficient to comprehensively regulate the complex matter of environmental liability. They primarily serve to codify basic principles and clarify several highly controversial issues. A great number of questions such as the one regarding the relations between the LTL and other environmental protection statutes, causation, burden of proof, relief, apportionment

¹²⁴ <http://ahlawyers.fyfz.cn/b/223408>.

of liability between polluters are supposed to be solved by a pertinent judicial interpretation.

2. Nature of Liability

In the mainstream opinion¹²⁵ environmental liability is conceptualized as a form of **80** no-fault liability. Pursuant to art. 65 LTL the polluter is liable for the damage he has caused. It can be inferred from art. 65 LTL that no fault is required for the establishment of liability. In contrast to the previous regulation in art. 124 GPCL, compliance with applicable environmental laws and regulations does no longer qualify as a defence under the LTL. In other words, unlawfulness is no longer required for the establishment of environmental liability. This constitutes a major amendment brought about by the LTL and has clarified the relevant debate among commentators.¹²⁶ Environmental liability is intended to cover both the damage to individual rights and to the environment.¹²⁷ However, no definition is provided for the key terms “environmental tort”, “polluter” and “pollution”. Environmental tort is generally described by commentators as an industrial or other human activity that causes pollution of the environment or ecological damage and thereby causes damage to personal rights, property, environmental interests or public property or gives rise to such likelihood of harm.¹²⁸ It is to note that both the commentary edited by the legislator and by the SPC confine the scope of application of chapter IIIV of the LTL to pollution caused by industrial or commercial enterprises.¹²⁹ Pollution caused by private persons is governed by art. 90 RRL, which is in its nature a fault-based liability.¹³⁰ According to the commentary edited by the SPC, the term of polluters includes the one who produces, sells, imports and uses waste and the one who collects, stores, transports, employs and disposes of waste¹³¹. In other words, a polluter is the one who controls and generates waste. Someone that causes pollution by an act other than above-mentioned conduct, such as a driver hitting

¹²⁵ KOZIOL/ZHU, 357, is of the opinion that environmental liability is no-fault liability only in one case where the polluter engages in highly risky activities.

¹²⁶ WANG Cheng, 86-88.

¹²⁷ XI Xiaoming, 457; a different opinion KOZIOL/ZHU, 357.

¹²⁸ ZHU Xiao (2008), 79-80.

¹²⁹ WANG Shengming, 326; XI Xiaoming, 454.

¹³⁰ ZHANG Bao, 91.

¹³¹ XI Xiaoming, 458.

another car loading with waste and causing the waste falling into a river, is not a polluter.¹³²

3. Shift in Burden of Proof of Causation

81 As environmental liability is triggered independent of fault, the trickiest issue turns out to be the burden of proof for causation. For example, environmental liability is rejected by Chinese courts where the plaintiff alleged that his harm was caused by pollution over a long period of time, but the defendant was able to show that the plaintiff was the only person suffering this damage in the group of people exposed to the pollution. In such a situation, the harm is deemed as an occasional event without causal linkage with the pollution. As with medical damage, the plaintiff often lacks expertise to evaluate and prove the impact of the pollution on his health or property. To solve the difficulties in evidentiary burdens, art. 66 LTL¹³³ provides a shift in burden of proof of causality between environmental exposure and damage. This wording corresponds to art. 4 of the “Some Provisions on Evidence in Civil Procedure”, however, due to its generality it is rather unclear whether the plaintiff is entirely relieved from the burden of proof for causation or still needs to make a *prima facie* showing of the causal link. So far, the judicial practice rather favors the latter and requires plaintiff to show the existence of a causal link between the damage and the pollution is probable, i.e. it has already been generally accepted that the pollution is apt to cause that damage. Only after the plaintiff has succeeded in making such a *prima facie* showing, it is up to the defendant to rebut the causation. Thus, the chance to win an environmental liability case in China is quite low.

4. Several Polluters

82 In many occasions harm is caused by several polluters. Often it is hard to identify who has causally contributed to the harm and to what extent. It could be that each of the polluters standing-alone would not have caused the harm or any of the polluters standing-alone would have caused the harm or the harm is caused by the aggregation of the polluters’ acts etc. The legal situation is straightforward, if all

¹³² Xi Xiaoming, 458.

¹³³ “In the event of a dispute over environmental pollution, the polluter shall bear the burden of proof regarding any exemption from or mitigation of liability and the causal relationship between his conduct and the damage.”

polluters consciously act in concert as this doubtlessly constitutes a joint tort in the sense of art. 8 (*supra* Chapter 10 at 38).¹³⁴ Accordingly, all polluters are jointly and severally liable. The issue is more delicate when joint fault is absent and a concerted action is denied. Basically, a distinction may be drawn between the following categories:

(1) Any of the polluters standing-alone would have caused the entire harm and the harm is indivisible. In such a case, art. 11 LTL is applicable and the polluters bear joint and several liability. **83**

(2) Each of the polluters standing-alone would not have caused the harm and the harm is caused by the aggregation of the polluters' acts. Commentators believe that this case is the scenario primarily intended to be addressed by art. 67 LTL¹³⁵, which sets out proportion liability for the polluters. The apportionment of the liability is determined by the factors such as the type and amount of its respective emissions.¹³⁶ In addition, the fact of compliance with relevant environmental standards is also to be taken into consideration.¹³⁷ So far, the LTL is silent on how to conduct the apportionment of joint liability based on these facts in practice. **84**

(3) Each of the polluters standing-alone would have caused a part of the harm, but the entire harm is caused by the aggregation of all polluters' acts. The harm is indivisible and the share of the contribution of each polluter cannot be identified. It is argued by commentators, that in this case, polluters bear also proportion liability. The statutory basis is art. 12 and art. 67 LTL.¹³⁸ The reason for the rejection of joint and several liability for joint danger in accordance with art. 10 LTL is that joint danger is only applicable to the case where the harm is not caused by all polluters, but only some of the polluters. **85**

(4) Each of the polluters standing-alone would have caused the harm, but the harm is not caused by all the polluters' acts. In other words, which polluter's act is causal for the harm is unascertainable. For instance, three producers in the same area put their waste of the identical nature in three same-looking containers and one of them **86**

¹³⁴ ZHU Xiao (2010), 107-108.

¹³⁵ According to ZHU Xiao (2010), 108-109, this article may also be applied to apportionment of liabilities between joint polluters in case of a joint pollution liability.

¹³⁶ ZHU Xiao (2010), 101, Fn. 19.

¹³⁷ XI Xiaoming, 468.

¹³⁸ ZHU Xiao (2010), 104.

is leaking and causes damage to the neighborhood. Following the above argument, this scenario can be seen as a case of joint danger.¹³⁹

5. Pollution Caused by a Third Party

87 Art. 68 LTL permits the victim to recover either from the polluter or a third party, if the harm is caused by a wrongful act of the third party. The polluter is entitled to claim indemnification from the third party after he was paid the compensation. This provision creates a joint and several liability between the polluter and the third party without specifying to whom this third party refers to¹⁴⁰ and for which situation art. 68 LTL is designed for. It is only natural to assume that the third party in the sense of art. 67 LTL is not a polluter, otherwise art. 67 LTL would have been applicable and thereby make art. 68 LTL obsolete. Thus, the third party's tortious act must have a different nature than pollution. Suppose that harm is caused in the course of transportation of waste due to an accident caused not by the transporter but solely by the other driver involved in the accident, the victim is entitled to recover from the polluter, meaning the one that has gave rise to the waste, even the causal link between the polluter's act and the harm is rather remote. Following the broad definition of polluters, the victim may also recover from the transporter, who is also included in the circle of polluters. One may argue that the imposition of liability upon the polluter is justified because it is easier for the victim to identify who is the source of the waste and polluters may be financially stronger than an individual third party. In addition, this harsh liability may give more incentives for the polluter to better supervise others dealing with the waste produced by him. It is likely that the legislator had this thought in mind when framing art. 68 LTL as art. 85 para. 4 of the Water Pollution Prevention Law¹⁴¹ already contains a comparable provision. It is to note however that art. 90 para. 1 Maritime Environment Protection Law¹⁴² follows a different approach and only allows the victim to sue the third party if the harm is

¹³⁹ *ZHU Xiao* (2010), 105-106.

¹⁴⁰ *BOLLWEG/DOUKOFF/JANSEN*, 103.

¹⁴¹ 水污染防治法, promulgated on 11th May, 1984, last revised on and effective from 28th February, 2008.

¹⁴² 海洋环境保护法, promulgated on 23th August, 1982, last revised on 25th December, 1999 and effective from 1st April, 2000.

caused by his negligence or intent. As this provision is deemed as a special provision in the sense of art. 5 LTL, it prevails over art. 68 LTL in application.¹⁴³

6. Relief

In terms of compensation, the victim may recover for property loss, bodily injury and mental distress. Courts may also order elimination of harm. A controversy exists with regard to ecological harm, which is neither explicitly mentioned in the existing statutes nor having been ordered by the court. In practice, polluters are usually penalized in the form of administrative fines for causing ecological harm instead of being required to pay monetary compensation. **88**

7. Defences

The LTL does not set out specific defences for environmental liability, while various environmental protection statutes provide for different exemptions and limitations of liability instances. The question at issue is the relations between general defences set out in the LTL, i.e. force majeure, comparative fault of the victim and fault of a third party, and these individual regulations. Basically, it is to assume that art. 5 LTL confers other special statutes priority in the application. The question of whether this principle is unconditionally applicable is to be solved in a contemplated judicial interpretation. **89**

8. Procedural Aspects

Both private victims and environmental agencies have standing to sue in environmental liability cases. Private victims may be represented by the relevant industrial associations in the proceeding. Government agencies, for instance fishery administration or environment protection agency, are granted standing by the specific environmental protection statutes such as art. 90 para. 2 Marine Environment Protection Law. They may recover ecological damage and expenses of cleaning up the pollution. Art. 55 Civil Procedure Law has granted NGOs and other **90**

¹⁴³ Xi Xiaoming, 470.

industry associations standing to sue in environmental tort cases. In practice, an environmental agency has been allowed to bring a public action against polluters.¹⁴⁴

IX. Animal Owner's Liability

1. Background

91 Animal owner's liability has attracted much attention lately in light of the rising number of pets, which is estimated to increase by 20% annually.¹⁴⁵ By 2008 there were approximately 100 million dogs in China. In Beijing alone one million ownerless dogs and cats were counted. Numerous cities and provinces have introduced municipal regulations governing dog ownership prior the enactment of the LTL. The number of animal-related injuries in cities such as Beijing and Shanghai exceeds 100,000 per annum.¹⁴⁶ Injuries by animals kept in zoos are also not uncommon. Against this background it is understandable that the legislature has devoted Chapter X of the LTL fully to animal owner's liability. Art. 127 GPCL provides no-fault liability of keepers of domesticated animals (饲养的动物). This provision is now replaced and altered by the Chapter X of the LTL, which also applies only to domesticated animals, i.e. livestock, pets and animals kept for research purpose, by circuses or the police and army¹⁴⁷. However, it is fair to say that Chapter X of the LTL has created more confusion than clarification regarding animal owner's liability. The legal regime of animal owner's liability is problematic, on the one hand, in that the terms of owner or keeper are not defined, and on the other, that the coupling of owner and keeper does not explicitly establish either joint liability or proportion liability. The relationship between the relevant provisions remains also to be clarified.

2. Nature of Liability

92 Based on the legislative history, the LTL is supposed to divide animals into three categories for the purpose of attribution: **no-fault liability** for regular domesticated animal and dangerous animals the breeding of which is not permitted, and **liability**

¹⁴⁴ The First Case of Public Interests Environmental Lawsuit in Yunnan (云南环境公益诉讼第一案二审维持原判) dated of 13th August, 2010, <http://ahlawyers.fyfz.cn/art/707530.htm>.

¹⁴⁵ *Department of the LAC for Civil Law*, 953 *et seqq.*

¹⁴⁶ *Department of the LAC for Civil Law*, 953 *et seqq.*

¹⁴⁷ *Xi Xiaoming*, 528.

based on presumed fault for zoo animals.¹⁴⁸ The zoo is not liable when it has fulfilled its duties of management (art. 81 LTL).

However, this intention may not be unambiguously concluded from the wording of **93** the relevant provisions. In particular, art. 78 LTL states “*Where any damage is caused by a domesticated animal, the keeper or manager thereof shall bear tortious liability unless he can prove that the victim deliberately or negligently incurred the damage, in which case his liability may be mitigated or exempted.*”, which can be construed as a general provision governing all the three categories of animals. This ambiguity has a direct impact on how to apply the defence stipulated in art. 78 LTL. Art. 80 LTL states “*Where any damage is caused by a fierce dog or other dangerous animal, the keeper or manager thereof shall bear tortious liability.*” Because no explicit defence is provided for in art. 80, the majority view holds that the owner of a dangerous animal is liable even if the victim acts with intent.¹⁴⁹

In contrast, there are three arguments supporting a minority opinion advocating the **94** applicability of reduction or exemption of liability to dangerous animals. First, the majority’s understanding contradicts the general rule on comparative fault established by art. 27 LTL, which bars recovery when the victim deliberately causes the harm (*supra* Chapter 10 at 65). Second, the minority’s construction is also easier to justify, since it could encourage the would-be victim to take more precaution when encountering dangerous animals and reduce the opportunity of being hurt. Third, there is a consensus that the defence stipulated in art. 78 LTL is also applicable to zoo animals, although in the wording of art. 81 LTL this defence is not explicitly mentioned either. As persuasive as these arguments may be, one has to admit that art. 80 LTL would be redundant if the liability for regular domesticated animals and that for dangerous animals are exactly the same. In making the distinction between the two and denying possibility of liability mitigation, the lawmaker has illustrated rather the intention to punish owners of dangerous animals, which expose the public to an unpredictable high hazard.

At first glance, art. 79 LTL, which stipulates that an owner or keeper is liable for **95** damages caused by animals due to the failure to take compulsory safety measures

¹⁴⁸ WANG Zhu (2010) believes that for all the three types of animals a no-fault liability is established.

¹⁴⁹ Xi Xiaoming, 536-537; ZHOU Youjun, 48-49.

such as failure to put muzzle or conduct vaccination, seems difficult to be put in context.¹⁵⁰

- 96** First, this provision suggests that the liability of an animal's owner or keeper is actually based on a rebuttable presumption of fault, not independent of fault as stipulated in arts. 78 and art. 80. Indeed, a literal interpretation would deny the owner's liability where he has taken the compulsory safety measures, although this construction would clearly contradict art. 78 LTL.
- 97** Second, it is disputable whether the possibility of liability mitigation and exemption is excluded in art. 79 LTL as in art. 80 LTL. Some argue if the defences stipulated in art. 78 LTL were also applicable to art. 79 LTL, no reasonable victim would invoke art. 79 LTL to claim compensation since it would be much easier to do it on the ground of art. 78 LTL where the plaintiff only has to prove the existence of the harm.¹⁵¹ Some reject this interpretation and hold the animal's owner is not barred from invoking the defences stipulated in art. 78 LTL with the argument that art. 78 LTL actually constitutes a general clause governing animal owner's liability and therefore also covers the situation provided in art. 79 LTL.¹⁵²
- 98** The prerequisite for art. 79 LTL is the noncompliance with relevant safety regulations. For example, the duty of wearing muzzle applies only when a fierce dog enters public space. Therefore, if an animal causes harm at home or in private areas, the animal's owner will be entitled to invoke the defences stipulated in art. 78 LTL.¹⁵³

3. Misconduct and Causation

- 99** In animal owner's liability the misconduct is seen in the particular risks to be expected from keeping an animal. Therefore, if someone, frightened upon seeing a dog in the elevator, fell to the ground and got hurt, the defendant may not defend himself by arguing that the dog did not attack victim. Since the dog is both the factual and proximate cause for the harm inflicted on the plaintiff, causation is also unquestionable in this case.

¹⁵⁰ BOLLWEG/DOUKOFF/JANSEN, 103.

¹⁵¹ Department of the LAC for Civil Law, 324; WANG Shengming, 395; WANG Zhu (2010); XI XIAOMING, 534-535.

¹⁵² ZHOU Youjun, 48.

¹⁵³ XI Xiaoming, 535.

4. Abandoned or Escaping Animals

According to art. 82 LTL the original owner or (original) keeper is liable for damages 100 caused by abandoned or escaping animals during the time of abandonment or escaping. That means, the liability of the original owner/keeper ceases after the abandoned or escaping animal is taken into custody by someone else or after the animal gained the status of wild animal.¹⁵⁴

5. Third Party's Liability

If a third party's fault results in damage caused by an animal, the victim has a claim 101 against the owner or keeper as well as the third party based on art. 83 LTL. The clause provides for the owner's indemnification against the third party. As the plaintiff's recovery is permitted independent of the fact whether the third party's act is the sole cause for the damage, art. 83 LTL alters the general defence stipulated in art. 28 LTL (*supra* Chapter 10 at 68), which exempts the defendant's liability when the harm is solely caused by the third party's act and augmented animal owner/keeper's liability. In this case, the liability between the third party and the animal owner/keeper is a non-genuine joint and several liability. One may question whether such a harsh liability for animal owners/keepers may be justified.¹⁵⁵ The justification for the stricter liability is comparable to other instances of non-genuine joint and several liability. Although no misconduct of the animal's owner is to be identified in this case, the risk is arguably still associated with the keeping of the animals. Controversial is the question whether an illegal holder of an animal, for instance a thief, is to be treated as a third party or an animal's keeper, when the stolen animal causes harm due to fault of such an illegal holder. No mainstream opinion has evolved so far.¹⁵⁶

X. Liability for Objects

1. Background

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¹⁵⁴ ZHOU Youjun, 50.

¹⁵⁵ BOLLWEG/DOUKOFF/JANSEN, 104.

¹⁵⁶ XI Xiaoming, 554-555.

In civil law countries, tort liability for buildings, things and animals is normally codified in their civil codes. In China, liability for objects (物件) covers only tangible items including buildings, structure or objects. This type of torts is governed by the GPCL and Chapter XI of the LTL.

2. Nature of Liability

- 103** In principle, Chapter X of the LTL consolidates existing rules provided by the GPCL and the “Interpretation concerning Personal Injuries”. Other than art. 126 GPCL, liability for buildings is divided into two norms in the LTL. Art. 85 LTL provides that the owner, keeper or user is liable for the damage caused by the falling-off (脱落) of a building (建筑物), structure (构筑物), other facility (其他设施) or the falling-down (坠落) of objects that are stored therein or attached thereto, if they cannot prove the harm is not caused by their fault. Thus, this liability is a liability based on presumed fault.¹⁵⁷ However, it remains to be clarified whether this liability is a joint and several liability.¹⁵⁸ In contrast, in the event of a structural collapse (倒塌) the owner (建设单位) and the construction company (施工单位) are subject to joint and several liability (art. 86 para. 1 LTL). Since the victim may recover from the owner and the construction company, even if the damage was caused by a third party, liability under arts. 85-86 LTL constitutes a non-genuine joint and several liability.
- 104** As arts. 86 and 89 LTL do not expressly mention the element of fault, some are of the opinion that both provisions have introduced no-fault liability,¹⁵⁹ while others argue that liability stipulated in art. 86 para. 1 LTL is a no-fault liability and art. 89 LTL constitutes a combination of no-fault liability with respect to persons who stored, dumped, lost or littered objects and liability based on presumed fault with respect to road management authority¹⁶⁰. A third opinion holds that liability for buildings and objects is either a fault-based liability or a liability based on presumed fault.¹⁶¹ The proponents for no-fault liability argue that the ground for the imposition of liability for collapse of buildings in art. 86 para. 1 LTL is the risk imminent to construction work,

¹⁵⁷ *Xi Xiaoming*, 568.

¹⁵⁸ *Xi Xiaoming*, 574 denies joint and several liability; *HAN Shiyuan* (2011), 38-39 also suggests that it is a proportion liability; detailed discussion cf. *WANG Hongliang*, 57.

¹⁵⁹ *HAN Shiyuan* (2010), 44-45.

¹⁶⁰ *Xi Xiaoming*, 574, 593.

¹⁶¹ *HAN Shiyuan* (2011), 30; *WANG Hongliang*, 54-56.

not the failure to discharge management duty as with art. 85 LTL; the same applies to art. 89 LTL, in which the liability is rather based on the risky nature of the activity.¹⁶² The opponents of no-fault liability assume that the misconduct in arts. 86 and 89 LTL is also the failure to comply with the relevant duty of care.¹⁶³ The reason for the separation between art. 85 and art. 86 LTL is actually that several severe structural collapse took place in the year of intense deliberation of the LTL and therefore drew considerable attention among the delegates.¹⁶⁴

Newly introduced was the controversial art. 87 LTL, which states that all users of a building have to pay on a **pro-rata basis** for damages caused by objects thrown out of or fallen off the building, if the actual wrongdoer cannot be identified. Only those users are excluded which can prove that they did not cause the damage. Art. 87 LTL is based on a series of likewise controversial court decisions in which such a claim against all owners or tenants was recognized. These earlier decisions had already been criticized for being unjust towards apartment owners, who as a result were liable for actions of their neighbors whom they could neither supervise nor control.¹⁶⁵ It is actually a common phenomenon in tort law that the actual wrongdoer can also not be identified, but it is rare that a certain group of people is held liable as a result. Distribution of risks and protection of the victim are regarded justification for art. 87 LTL.¹⁶⁶

Additional clauses include liability for the collapse of stacked objects, liability based on presumed fault (art. 88 LTL), liability caused by broken trees (art. 90 LTL), liability for failure to install warning notices or to take safety measures during excavation work or subterranean construction work on public premises or roads (art. 91 para. 1 LTL) as well as liability for subterranean structures such as storm drains (art. 91 para. 2 LTL).

¹⁶² LIANG Huixing, 11-12.

¹⁶³ WANG Hongliang, 56.

¹⁶⁴ WANG Hongliang, 56; XI Xiaoming, 570 et seqq.

¹⁶⁵ XI Xiaoming, 576 et seqq.

¹⁶⁶ WANG Hongliang, 59-60.

Relevant Laws & Regulations

<i>Title</i>	<i>Promulgation Date</i>	<i>Effective Date</i>	<i>Last Revision Effective from</i>
Maritime Environment Protection Law (海洋环境保护法)	8/23/1982	3/1/1983	12/25/1999
Water Pollution Prevention Law (水污染防治法)	5/11/1984	11/1/1984	28/2/2008
General Principles of Civil Law (民法通则)	4/12/1986	1/1/1987	8/27/2009
Opinions of the Supreme People's Court on Several Issues concerning the Implementation GPCL of the People's Republic of China (Trial Implementation) (最高人民法院关于贯彻执行《中华人民共和国民事诉讼法》若干问题的意见(试行))	1/26/1988	1/26/1988	12/24/2008
Reply of the Supreme People's Court on the Question of Whether the Right to Reputation of a Deceased Person Should Be Legally Protected (最高人民法院关于死亡人的名誉权应依法保护的复函)	4/12/1989	4/12/1989	---
Reply of the Supreme People's Court on the Question of Whether the relatives of a deceased natural person is entitled to sue if its reputation is infringement (最高人民法院关于自然人死亡后,其名誉受到侵犯,其直系亲属是否有权提起诉讼问题的函)	4/12/1989	4/12/1989	---
Environmental Protection Law (环境保护法)	12/26/1989	12/26/1989	
Opinions of the Supreme People's Court on Certain Issues Regarding the Implementation of the Civil Procedure Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见)	7/14/1992	7/14/1992	12/24/2008
Product Quality Law (产品质量法)	2/22/1993	9/1/1993	8/27/2009
Answers of the Supreme People's Court on Several Issues Relevant to the Trial of Cases Involving Rights to Reputation (最高人民法院关于审理名誉权案件若干问题的解答)	8/7/1993	8/7/1993	---
Anti-Unfair Competition Law (反不正当竞争法)	9/2/1993	12/1/1993	
Provisions of the Limitation of Liability With Respect to the Carriage of Passengers by Sea Between the Ports (港口间海上旅客运输赔偿责任限额规定)	12/17/1993	1/1/1994	---
Law on State Compensation (国家赔偿法)	5/12/1994	1/1/1995	12/1/2010

Insurance Law (保险法).	6/30/1995	10/1/1995	10/1/2009
Interpretations the Supreme People's Court to Several Questions in the Trial of Cases Involving Rights to Reputation (最高人民法院关于审理名誉权案件若干问题的解释)	8/31/1998	9/15/1998	---
Interpretation of the Supreme People's Court on Several Issues in the Trial of Cases Involving Compensation for Personal Injury Caused by Electric Shock (最高人民法院关于审理触电人身损害赔偿案件若干问题的解释)	1/10/2001	1/21/2001	---
Interpretation of the Supreme People's Court on Several Issues Concerning the Ascertainment of Compensation Liability for Emotional Damages in Civil Torts (最高人民法院关于确定民事侵权精神损害赔偿责任若干问题的解释)	3/8/2001	3/10/2001	---
Measures on Recycling of Scrapped Cars (报废汽车回收管理办法)	6/16/2001	6/16/2001	---
Some Provisions of the Supreme People's Court on Evidence in Civil Procedure (最高人民法院关于民事诉讼证据的若干规定)	12/21/2001	4/1/2002	12/31/2008
Reply of the SPC on the Inquiry Regarding the Question of Whether the Original Owner is Liable for the Damage Caused by a Motor Vehicle in the Case of Multiple Sales of the Vehicle without Conducting Transfer of Owner's Name in the Vehicle Register (最高人民法院关于连环购车未办理过户手续,原车主是否对机动车发生交通事故致人损害承担责任的请示的批复)	12/31/2001	12/31/2001	---
Reply of the Supreme People's Court to the Question of Whether the Victim May Sue the Trademark Owner in a Product Liability Case (最高人民法院关于产品侵权案件的受害人能否以产品的商标所有人为被告提起民事诉讼的批复)	7/11/2002	7/28/2002	---
Road Traffic Safety Law (道路交通安全法)	10/28/2003	5/1/2004	4/22/2011
Interpretation of the Supreme People's Court on Several Issues Concerning the Law Applicable in Hearing Cases of Compensation for Personal Injury (最高人民法院关于审理人身损害赔偿案件适用法律若干问题的解释)	12/26/2003	5/1/2004	---
Act of Compulsory Liability Insurance for Motor Vehicles (机动车交通事故责任强制保险条例)	3/21/2006	7/1/2006	12/17/2012
Provisions on the Limited Compensation Liabilities of	2/28/2006	3/28/2006	---

Carriers in Civil Aviation Transport (国内航空运输承运人赔偿责任限额规定)

Regulation on the Protection of the Right to Network Dissemination of Information (信息网络传播权保护条例)	5/18/2006	7/1/2006	---
Reply of the State Council on Liability for Compensation for Nuclear Accidents (国务院关于核事故损害赔偿责任问题的批复)	6/30/2007	6/30/2007	---
Regulation on the Emergency Rescue, Investigation and Handling of Railway Traffic Accidents (铁路交通事故应急救援和调查处理条例)	7/11/2007	9/1/2007	---
Law on Tort Liability (侵权责任法)	12/26/2009	7/1/2010	---
Interpretation of the Supreme People's Court on Issues Concerning the Application of Law in the Trial of Cases Involving Disputes over Compensation for Personal Injuries During Railway Transportation (最高人民法院关于审理铁路运输人身损害赔偿纠纷案件适用法律若干问题的解释)	3/3/2010	3/16/2010	---
Social Insurance Law (社会保险法)	10/28/2010	7/1/2011	---
Interpretation of the Supreme People's Court on Issues Concerning the Application of Law in the Trial of Cases Involving Traffic Accidents (最高人民法院关于审理道路交通事故损害赔偿案件适用法律若干问题的解释)	27/11/2012	21/12/2012	

Part IV Property

Chapter 13. Overview

Literature: *Bu Xianghong* (卜祥洪), On the Nature and Meaning of Possession (论占有的法律性质及其涵义), *Qilu Journal* (齐鲁学刊) 2010, No. 3, 91-96, cited as *Bu Xianghong* (2010). *Bu Xianghong* (卜祥洪), On the Prerequisites and Scope of the Claim for Compensation for Infringement on Possession (论占有损害赔偿的请求权基础与范围), *Contemporary Law Review* (当代法学) 2011, No. 4, 61-66, cited as *Bu Xianghong* (2011). *Bu Yuanshi* (卜元石), Introduction to Chinese Law (Einführung in das Recht Chinas), Munich 2009. *Hu Tian* (胡田), Some Doubts over the “Dichotomy” of Joint Ownership (共有“两分法”质疑), *Journal of Nanchang University (Humanities and Social Sciences Edition)* (南昌大学学报 (人文社会科学版)) 2010, no. 2, 51-54. *Li Yongjun* (李永军), Reflections on the First Part of the Real Rights Law (对《物权法》第一编的反思), *Contemporary Law Review* (当代法学) 2010, No. 2, 7-20. *Liu Baoyu* (刘保玉), The Achievements and Shortcomings of China’s Real Rights Law (中国物权法的成就与不足), *Legal Forum* (法学论坛) 2008, No. 5, 21-28. *STÜRNER*, The New Chinese Real Rights Law from a German Perspective (Das neue chinesische Sachenrecht aus deutscher Sicht), in: *Bu Yuanshi* (卜元石) (ed.), Chinese Civil and Commercial Law from a German Perspective (Chinesisches Zivil- und Wirtschaftsrecht aus deutscher Sicht), Tübingen 2008, 3-17. *Sui Pengsheng* (隋彭生), On the Right of Possession (论占有之本权), *Studies in Law and Business* (法商研究) 2011, No. 2, 86-95. *TANG Dehua* (唐德华)/*GAO Shengping* (高圣平) (ed.), New Commentary on the General Principles of Civil Law and Additional Provisions (民法通则及配套规定新释新解), 2nd edition, Beijing 2003. *Tu Changfeng* (涂长风), Secured Transactions, in: *Bu Yuanshi* (卜元石) (ed.), Chinese Business Law, Munich 2010, 183-219. *WANG Yi* (王轶), On Chinese Elements in China’s Civil Legislations (论中国民事立法中的“中国元素”), *Law Science Magazine* (法学杂志) 2011, No. 4, 27-32. *WERTHWEIN, Simon*, Corporations and Partnerships, in: *Bu Yuanshi* (卜元石) (ed.), Chinese Business Law, Munich 2010, 15-54. *ZHANG Yuxin* (张喻忻), On Protection to Possession in Tort Liability Law (论侵权责任法对占有的保护), *Law Science Magazine* (法学杂志) 2010, No. 2, 113-115; cited as *ZHANG Yuxin* (2010b).

I. The Real Rights Law in its Context

- 1 The Real Rights Law (RRL) forms the central piece of Chinese property legislation. It took 15 years and eight readings¹ before the RRL was promulgated on March 16, 2007 and came into effect on October 1, 2007. Even though the bill had gone

¹ *Liu Baoyu*, 21.

through an exceptionally lengthy and controversial process (including consultation of the public, which generated 11,543 replies within less than six weeks²), only 2799 of the 2889 members of the NPC voted in support of the RRL, showing an arguably unprecedented lack of consensus in the history of the NPC.³

Two of the numerous debated issues touched on fundamental questions. The first one dates back to 2001 when Zheng Chengsi, a renowned professor at the Chinese Academy of Social Sciences, claimed that the new law's scope should not be restricted to corporeal things but should also cover immaterial goods. Therefore, the title of the new law should be Property Law (财产法) rather than Real Rights Law (物权法). Although this suggestion triggered quite some debate among legal scholars,⁴ it has not gained the legislator's acceptance.

Secondly, it was argued that the draft RRL was unconstitutional in that it provided for equal protection to real rights of the state and of individuals, whereas pursuant to art. 12 para. 1 of the Constitution, "socialist public property is inviolable".⁵ While the debate did not result in any material changes to the RRL, it did leave its marks in various provisions. Art. 3 RRL is probably the most prominent example. It sounds very much like a provision of the Constitution: "In the primary stage of socialism, the State upholds the basic economic system under which public ownership is dominant and the economic sectors of diverse forms of ownership develop side by side. (...)". This is only understandable against the background of said debate.⁶

Overall, the symbolic meaning of the mere fact that the RRL was adopted far exceeds the amount of actual legal innovation contained in the Law.⁷ There are, however, substantial improvements brought along by the RRL. From a technical point of view, it is most welcome that the RRL sets out a body of general provisions with respect to real rights (arts. 1-38 RRL), although it is argued that the internal

² Legal Daily (法制日报) of 7th September, 2005, available at http://www.legaldaily.com.cn/bm/content/2005-09/07/content_191575.htm.

³ Liu Baoyu, 21.

⁴ See, in particular, the reaction to ZHENG's suggestion by LIANG HUIXING (梁慧星), Drawing up a Real Rights Law or a Property Law? (是制定“物权法”还是制定“财产法”?) dated 7th January, 2002; <http://review.jcrb.com.cn/ournews/asp/readNews.asp?id=69962>,

⁵ Liu Baoyu, 21. For details regarding the background of this debate (which presumably stemmed from intra-Communist Party rivalry), cf. BU Yuanshi, 130 and MÜNZEL, Note 1.

⁶ Cf. Li Yongjun, 9.

⁷ WANG Yi, 27, 30; Li Yongjun, 7.

structure of some of these provisions could be more stringent.⁸ Before the RRL came into force, only arts. 71-83 of the General Principles of Civil Law (hereinafter: GPCL) contained a few general provisions on “property ownership and related property rights” (财产所有权和与财产所有权有关的财产权). These rather vague rules have become practically irrelevant⁹ as the RRL constitutes the *lex specialis* as well as the *lex posterior* in relation to arts. 71-83 GPCL. Moreover, the RRL introduced provisions on condominium property (*infra* Chapter 15), which is another major improvement.

- 5 The RRL is a perfect example of a mixed law. It features elements of Japanese, French, German, and Anglo-American law as the legislator was keen to use foreign jurisdictions as a source of reference.¹⁰ Another characteristic of the RRL is its openness. A number of provisions take a rather general approach, leaving room for special laws or regulations to govern the relevant issues in more detail,¹¹ as well as for further scholarly discussion.¹² However, the discussion relating to the Tort Liability Law has, to a certain extent, distracted legal scholars’ attention away from the RRL.¹³

II. Other Sources of Law

- 6 While the RRL certainly is the centerpiece of Chinese legislation on real rights, it is not the only source of law in this area. The RRL’s openness mentioned above is partly due to the fact that older provisions that cover certain aspects of real rights law remained in effect despite the RRL’s entry into force. Instead of replacing and entirely restating the existing (yet fragmentary) legal framework by the RRL, the RRL was added to the existing legal framework. As far as immovable property is concerned, there are a number of laws that became effective years before the RRL, in particular the Land Administration Law (1987) and the Urban Real Estate Administration Law (1995). Real security rights are still governed by the Guaranty Law (1995) as far as its provisions do not conflict with the RRL (art. 178 RRL). The

⁸ *Li Yongjun*, 9, notes that most of the eight articles in the first chapter (titled “Basic Principles”) do not deal with basic principles of real rights law (the only exceptions being arts. 5 and 6).

⁹ Cf. *Bu Yuanshi*, 87 at 39.

¹⁰ *Liu Baoyu*, 26 *et seq.*, terms the RRL a “cocktail” (鸡尾酒); *Li Yongjun*, 15, in a slightly disapproving way refers to a “cold platter phenomenon” (“拼盘” 现象).

¹¹ *Liu Baoyu*, 23 (left column), 24 (right column); *BU YUANSHI*, 127 at 2.

¹² *Bu Yuanshi*, 126 at 1.

¹³ *Li Yongjun*, 7.

transfer of movable property is to some extent covered by the Contract Law (CL) of 1999, along with a recent (2012) judicial interpretation on purchase contracts issued by the SPC. As with most areas of Chinese law, real rights law covers the full range of the hierarchy of norms, beginning with the Constitution at the top and down to particular provisions such as the Regulations on the Expropriation of Buildings on State-Owned Land and Compensation, or the Measures for Building Registration.

III. Functions of Real Rights Legislation

The function of real rights is to attribute assets¹⁴, i.e. their benefits (and burdens) to one or more natural or legal persons and to exclude all other persons from interfering with such assets. Real rights legislation provides rules on how real rights come into existence, cease to exist, as well as on how they can circulate, be it by way of a legal transaction or by operation of law. 7

While real rights on the one side secure the physical basis for the use of civil rights and liberties, they also involve a potential of perpetuating or even exacerbating economic (and, by association, social) disparity. This is why jurisdictions protect and at the same time impose limits on real rights, e.g. by means of taxation, anti-monopoly legislation and/or by providing for the possibility of expropriation (for the latter see *infra* Chapter 14 at 65 *et seq.*). 8

IV. Sole Ownership

The owner of an asset is entitled to possess, use, dispose of, and obtain profits from such assets and to exclude any other person's interference.¹⁵ He may also create encumbrances in his real rights in favor of a third party.¹⁶ The exercise of this extensive entitlement is limited in that it may neither offend laws or social morality, nor jeopardize the public interests or the lawful rights and interests of another person.¹⁷ 9

¹⁴ Cf. art. 1 RRL.

¹⁵ Art. 2 para. 3, 39 RRL.

¹⁶ Art. 40 RRL.

¹⁷ Art. 7 RRL. In a more general manner, art. 39 states that the rights mentioned therein shall be exercised "in accordance with the law".

V. Joint Ownership

- 10 There can never be more than one ownership right with respect to one specific property (一物一权).¹⁸ However, several natural or legal persons can jointly hold the right of ownership (or of encumbrance¹⁹) as joint owners (共有人).²⁰

1. Two Types of Joint Ownership

- 11 The two types of joint ownership are considered co-ownership by shares (按份共有) and common ownership (共同共有).²¹ In the absence of an explicit agreement as to which type of joint ownership shall apply, the joint owners are deemed to be co-owners by shares unless family ties or other relationships (家庭关系等)²² exist between them.²³ By contrast, the legal presumption that was applied with respect to art. 78 GPCL was in favor of common ownership.²⁴
- 12 In Chinese literature there is some criticism regarding the dichotomy between co-ownership by shares and common ownership under the RRL. *De lege ferenda* the proposal is put forward that the RRL should only contain provisions on co-ownership by shares, while special rules for certain areas of law (such as partnership enterprises, community of heirs, etc.) should be set out in the respective laws.²⁵
- 13 Even from a German law perspective, it is somewhat surprising that the Chinese legislator has chosen to adopt the German law concept of common ownership. In recent years, German law has seen quite some skepticism regarding common ownership, and the German judiciary has acknowledged (partial) legal capacity of

¹⁸ Cf. *Li Yongjun*, 9.

¹⁹ Art. 105 RRL.

²⁰ Art. 93 RRL.

²¹ Arts. 94, 95 RRL.

²² "Family ties" are governed by arts. 13-30 Marriage Law (婚姻法), promulgated on 10th September, 1980 and effective from 1st January, 1981; last revision effective from 28th April, 2001. The meaning of "other relationships", however, is unclear. For example, there is debate about whether ownership of a partnership enterprise's property qualifies as common ownership (cf. *Hu Tian*, 53 (right column)).

²³ Art. 103 RRL. Strictly speaking, the wording of this provision does not make it clear whether or not in cases of family or other relationships no presumption shall apply or whether in such circumstances the joint owners shall be deemed to be common owners.

²⁴ Cf. Clause 88 of the Opinions of the SPC on Several Issues concerning the Implementation of the GPCL of the People's Republic of China (For Trial Implementation). This clause 88 was abolished as of 24th December, 2008, by clause 24 of the Decision of the SPC on Abolishing the Relevant Judicial Interpretations promulgated before the End of 2007 (Seventh Batch) (最高人民法院关于废止 2007 年底以前发布的有关司法解释(第七批)的决定), promulgated on and effective from 18th December, 2008.

²⁵ *Hu Tian*, 53, 54.

partnerships in order to avoid certain difficulties in connection with common ownership.²⁶

2. Common Features

In the absence of an agreement, each of the joint owners (common owners or co-owners by shares) is entitled and obliged to manage the jointly owned property.²⁷ A joint owner is entitled to request severance if he has a compelling reason to do so, even if the joint owners have contractually agreed not to sever the property.²⁸ When the joint owners fail to agree on the method of severance, the property itself is divided unless this is difficult or would reduce the property's value. In cases where the latter applies, the property is liquidated and the proceeds are severed.²⁹ The joint owners who have not requested severance may claim compensation for any damage caused by the severance.³⁰

3. (Non-) Existence of Individual Shares

The key difference between common ownership and co-ownership by shares is that only under co-ownership by shares can each of the joint owners hold an individual share in the ownership right. By contrast, under common ownership there are no individual shares. Rather, the common owners hold the ownership right collectively.

This difference can be seen in arts. 97 and 101 RRL according to which the disposal of property under common ownership requires the consent of all common owners, whereas each co-owner by shares may freely transfer his share in the property (cf. *infra* at 19). Consequently, the question of the size of shares is only addressed (and only arises) in cases of co-ownership by shares. If the co-owners by shares have not explicitly agreed upon the proportion of their shares, the shares are determined in proportion to the amount of the respective co-owner's investment. When the amount of investment cannot be determined, the co-owners are deemed to hold equal shares.³¹

²⁶ Cf. STÜRNER, 9.

²⁷ Art. 96 RRL.

²⁸ Art. 99 RRL.

²⁹ Art. 100 RRL.

³⁰ Art. 99 cl. 2 RRL.

³¹ Art. 104 RRL.

- 17 It should be noted that the ownership right, not the property itself, is divided into shares, so the shares are not related to specific parts of the property. This is why, despite the fact a co-owner is free to transfer his share in the property, measures with respect to the property itself require a joint decision (*infra* at 18 *et seqq.*). If the property itself is severed³² (resulting in parts which can then be subject to separate ownership rights), the joint ownership will cease to exist.³³

4. Disposal and Major Repair

- 18 Pursuant to art. 97 RRL, disposal of or major repair with regard to the jointly owned property requires consent from all the common owners or, in cases of co-ownership by shares, from the co-owners by shares whose shares account for two thirds of the total shares. In general, “disposal” (处分) encompasses transfer³⁴ as well as encumbrance³⁵. It is, however, doubtful whether the two-thirds-rule can actually apply to the disposal of co-ownership by shares.
- 19 This doubt arises from the fact that pursuant to art. 101 RRL, a co-owner by shares is free to transfer his shares in the property, the only restriction being that the other co-owners have the right of preemption under equal conditions. Likewise, by way of argument *a fortiori*, a co-owner by shares is also entitled to encumber his share without the need for consent by all or a portion of the other co-owners (but again, subject to a preemptive right of the other owners). Art. 101 specifically addresses co-ownership by shares, whereas art. 97 refers to joint ownership in general, so art. 101 constitutes a special rule which prevails over the general rule set out in art. 97.
- 20 Therefore, in the case of co-ownership by shares, the two-thirds-rule does not apply to the disposal (transfer or encumbrance) of the property, but only to major repair with regard to such property. The only way to transfer or encumber property under co-ownership by shares is that every single co-owner by shares transfers or encumbers his share.³⁶

³² See *supra* at 14 and *infra* at 21.

³³ Cf. art. 99 RRL.

³⁴ Cf. art. 106 RRL.

³⁵ Cf. arts. 39, 40 RRL.

³⁶ The same applies under, e.g. art. 747 cl. 2 of the German Civil Code (*Bürgerliches Gesetzbuch*).

5. Severance

Where the joint owners have not contractually excluded the severance of the 21 property (for this case see *supra* at 14), a co-owner by shares may at any time (i.e. without having to give a reason) request severance. By contrast, a common owner may only do so for a compelling reason or in a situation where the basis for the common ownership has ceased to exist.³⁷ One could argue, however, that this is somewhat redundant as the latter case will virtually always constitute a “compelling reason”.

6. Claims and Liabilities

With respect to claims and liabilities arising in connection with the joint property, 22 art. 102 RRL draws a distinction between external and internal relations. The external relation exists between the joint owners on the one hand and a third party on the other hand, while the internal relation exists among the joint owners.

In their external relation towards a third party, the joint owners enjoy claims as joint 23 and several creditors and bear liabilities as joint and several debtors, except when laws provide otherwise or where the third party is aware that the joint owners are not associated in the aforesaid manner.³⁸ This means that each of the joint owners is individually entitled to demand that the third party fulfill its obligation or that each of the joint owners is obliged to perform the entire debt, as the case may be.³⁹

Internally, each of the co-owners by shares enjoys claims and bears liabilities in 24 proportion to his shares, while common owners enjoy claims and bear liabilities as joint creditors or joint debtors (but again, the joint owners may agree otherwise).⁴⁰ If a co-owner by shares clears a debt in excess of his due, he will be entitled to recover said excess from the other co-owners by shares.⁴¹ Likewise, a common owner who performs the entire debt is entitled to reimbursement from the other common owners in accordance with their shares of the debt.⁴² Because in cases of common ownership the ownership right is not divided into shares (according to

³⁷ Art. 99 RRL.

³⁸ Art. 102 RRL.

³⁹ Art. 87 GPCL.

⁴⁰ Art. 102 RRL.

⁴¹ Art. 102 cl. 2 RRL.

⁴² Art. 87 GPCL.

which the shares of the debt could be determined), the respective common owner's share in the debt depends on the provisions of the law and/or contract governing the internal relation among the common owners (e.g. a partnership agreement).

- 25** With respect to management fees and other charges for the joint property, art. 98 RRL explicitly stipulates that (in the absence of an explicit agreement) these be borne by co-owners by shares in proportion to the amount of their respective shares and by common owners as joint debtors. This provision, which obviously relates to the joint owners' internal relations,⁴³ amounts to nothing more than a reaffirmation of the more general rule set out in art. 102 RRL.

VI. Different Types of Owners

- 26** The RRL contains separate sets of provisions for different types of holders of real rights. Real rights of the state (which are considered to be real rights of the people⁴⁴), of collectives, of individuals, and of legal persons are governed by arts. 45-57, 58-63, 64-66, and 68-69, respectively.⁴⁵ This separation resulted in a certain degree of repetitiveness⁴⁶, but was unavoidable⁴⁷ given the political background (reflected by art. 3 RRL) against which the RRL was enacted.
- 27** A number of assets can only be held by certain types of owners. In particular, only the state or a collective can own land.⁴⁸ Mineral resources, waters, and sea areas belong exclusively to the state.⁴⁹ Natural resources such as forests, mountains, grasslands, wastelands, and tidal flats can only be owned by the state or by a collective.⁵⁰ As far as the state and collectives are concerned, the Law sets out specific rules appointing the State Council, government departments, institutions

⁴³ Otherwise the legislator would have chosen the term "joint and several" (连带) instead of "jointly" (共同) with respect to the common owners' liability, cf. the respective wording in art. 102 at the beginning and at the end of the first sentence.

⁴⁴ Cf. art. 45 para. 1 RRL.

⁴⁵ Art. 67 RRL falls within the scope of company law rather than real rights law. It stipulates that the state, collective, and individuals may invest in enterprises by way of contribution in kind and that such investors will only have indirect control over the contributed assets.

⁴⁶ Art. 61 repeats arts. 39 and 40, while arts. 56, 63 para. 1 and 66 repeat art. 4 RRL.

⁴⁷ *Liu Baoyu*, 25 (left column) at note 1.

⁴⁸ Arts. 47, 58 no. 1 RRL.

⁴⁹ Art. 46 RRL.

⁵⁰ Arts. 48, 58 no. 1 RRL.

sponsored by the state, or representatives of collectives to exercise the owner's rights⁵¹ or, in cases of enterprises invested by the state, the investor's rights.⁵²

VII. Encumbrances

Apart from full ownership, whether in the form of sole ownership or in the form of **28** joint ownership, the RRL provides for encumbrances, i.e. usufructuary rights (see *infra* Chapter 16) and real security rights⁵³. The creation of an encumbrance means that certain elements within the broad scope of the owner's rights are cut out and are assigned to a person other than the respective owner.

VIII. Objects of Real Rights

Real rights are rights over things.⁵⁴ Things within the meaning of the RRL include **29** movables and immovables,⁵⁵ i.e. tangible assets as opposed to incorporeal assets such as contractual rights or intellectual property. However, apart from things, rights can also be objects of real rights where laws stipulate so.⁵⁶ The RRL itself contains an example of such provisions: Art. 223 RRL lists a number of rights that can be pledged (the pledge being one of several types of real security rights (担保物权), which in turn constitute a type of real right⁵⁷).⁵⁸

As the RRL follows the continental European model of separation of contractual **30** rights on the one hand and real rights on the other hand,⁵⁹ the scope of real rights is considerably narrower than the scope of "property rights" in the context of Anglo-American law. Within the limits of the continental European model, however, real rights under Chinese law cover a very broad range of objects because there is no definition or further specification of the meaning of the terms "movables" and "immovables". Apart from all kinds of movable and immovable assets (the latter including land, buildings and parts of buildings), objects of real rights also include

⁵¹ Arts. 45 para. 2, 53, 54 60 RRL.

⁵² Art. 55 RRL; *Liu Baoyu*, 25.

⁵³ Art. 2 para. 3 RRL; for details, see *Tu Changfeng*, 196 *et seqq.*

⁵⁴ Art. 2 para. 3 RRL.

⁵⁵ Art. 2 para. 2 RRL.

⁵⁶ Art. 2 para. 2 RRL.

⁵⁷ Cf. the heading of part 4 of the RRL ("Real Security Rights" (担保物权) and art. 2 para. 3 RRL).

⁵⁸ For details regarding pledges on rights, see *Tu Changfeng*, 212 *et seqq.*

⁵⁹ *Bu Yuanshi*, 131 at 18; also cf. *Li Yongjun*, 10.

natural resources (such as forests, mountains, grasslands, wastelands, and tidal flats) and the spectrum of electromagnetic waves.⁶⁰

IX. Principles of Real Rights Law

31 Chinese real rights law is based on a number of guiding principles. Even though there is a certain amount of variance within these principles, it is nevertheless useful to be aware of them when construing and applying the RRL.

1. Equal Protection of different Types of Owners

32 Pursuant to art. 4 RRL, real rights held by the state, collectives, individuals and “other” holders of real rights (i.e. legal persons) are protected by law. This rule is referred to as the “principle of equal protection” (平等保护原则)⁶¹, even though art. 4 does not explicitly provide for “equal” protection (the word “equally” was deleted in the course of law-making). At any rate, the RRL is the first ordinary (i.e. sub-constitutional) piece of Chinese legislation that explicitly provides for the protection of the real rights of individuals, following an amendment of the Constitution in 2004 to that effect.⁶²

2. Absoluteness

33 The holder of a real right is entitled to directly control the object of said real right and to exclude any other person’s interference.⁶³ This principle of absoluteness of real rights (物权绝对原则)⁶⁴ distinguishes real rights from contractual rights. Contractual rights as opposed to real rights do not extend beyond the relationship between the parties to the respective contract; there is no “object” to a contractual right.

⁶⁰ Arts. 48, 50 RRL.

⁶¹ Cf. *Liu Baoyu*, 22 (right column).

⁶² Pursuant to art. 13 para. 1 of the Constitution, the citizens’ lawful private property (合法的私有财产) is inviolable.

⁶³ Art. 2 para. 3 RRL.

⁶⁴ In Chinese: 物权绝对原则 (*Liu Baoyu*, 22 (left column)) or 物权法定主义 (*Li Yongjun*, 12).

3. Legal Prescription (*numerus clausus*)

The types and content of real rights are defined by law.⁶⁵ This means that any right 34 over movables or immovables must fit into one of the models prescribed by law (particularly by the RRL). Under this “principle of legal prescription of real rights” (物权法定原则)⁶⁶ or *numerus clausus* of real rights, an owner’s rights can only be restricted or otherwise modified by contract, whereas such contractual restrictions are only effective in the “internal” relationship between the parties to the respective contract.

The principle of legal prescription of real rights is an essential condition for the 35 absoluteness of real rights.⁶⁷ It is only practicable to place a legal obligation on any third party to respect and not infringe upon other persons’ real rights, where the law clearly defines the content of such real rights.

Furthermore, it will facilitate the circulation of assets, or more exactly the circulation 36 of real rights (*infra* Chapter 14 at 1), if the acquirer of a real right can be sure of the content of such a right. As stated above, under the principle of legal prescription of real rights, a contractual restriction agreed upon between the seller and a third party will not be binding on the buyer.⁶⁸

4. Specificity

The principle of specificity, according to which a real right must refer to a specific 37 thing, flows from the principles of absoluteness and legal prescription of real rights.⁶⁹ Just as the principle of absoluteness, the principle of specificity of the object of real rights (客体特定原则)⁷⁰ is laid down in art. 2 para. 3 RRL⁷¹. Like the principle of legal prescription of real rights, the principle of specificity serves legal clarity. Especially concerning the transfer of a real right, it must be clear which object the transfer affects.

⁶⁵ Art. 5 RRL.

⁶⁶ Cf. *Li Yongjun*, 11; *Liu Baoyu*, 22 (left column).

⁶⁷ *Li Yongjun*, 12.

⁶⁸ A significant exception being art. 229 CL, according to which the buyer will be bound by a lease contract concluded between the seller and a lessee before sale.

⁶⁹ *STÜRNER*, 13.

⁷⁰ Cf. *Li Yongjun*, 9.

⁷¹ Surprisingly, *Li*, 9 seems to be of the opinion that the RRL does not expressly refer to the principle of specificity.

5. Publicity

38 Finally, Chinese real rights law has also adopted the principle of publicity of real rights (物权公示原则).⁷² This means that the creation, alteration, transfer, or extinction of real rights in immovables has to be registered and that the creation or transfer of real rights in movables requires delivery of the respective thing.⁷³ The principle of publicity is a means to ensure that the allocation of real rights and any change thereto is visible to the public.

X. Protection of Real Rights

1. Real Rights Claims vs. Tort Liability

39 The protection of real rights is governed by the third chapter (arts. 32-38) of the RRL. Only arts. 33-35 deal with real rights claims (claims resulting from the real right itself), whereas arts. 36 and 37 concern claims which are of a tort law nature.⁷⁴ A claim for restitution of original condition under art. 36⁷⁵, or for compensation under art. 37 only arises when a person “culpably” damages another person’s property. By contrast, the rights to demand return, removal of impairment, or elimination of hazard under arts. 34 and 35 arise whenever a thing is possessed without the right to do so or a real right is infringed, or likely to be infringed upon. Tort liability is based on fault, whereas real right claims are solely based on the absoluteness of the real right.⁷⁶

2. Other Provisions

40 Art. 32 RRL is somewhat redundant as practically any civil dispute can be settled by means of conciliation, mediation, arbitration or litigation.⁷⁷ Likewise art. 38 only states that the remedies mentioned above can be combined and that liability under

⁷² Cf. *Liu Baoyu*, 22 (left column); *Li Yongjun*, 9.

⁷³ Arts. 6, 9, 23 RRL.

⁷⁴ *Bu Xianghong* (2011), 63. Even more stringently, *Liu Baoyu*, 24 (right column), only mentions arts. 34 and 35 as real rights claims (物权请求权). *Li Yongjun*, 17-18 refers to claims resulting from the real right itself as “protection of a real rights nature” (物权性保护) as opposed to the more general concept of the protection of real rights (物权的保护), which is used in the heading of Chapter 3 of the RRL.

⁷⁵ *Liu Baoyu*, 26 (right column) quite rightly criticizes that part of the wording (“repair, reworking, or replacement”) has apparently been transplanted from the law of obligations (more precisely, from art. 134 GPCL) and does not fit into the context of real rights protection.

⁷⁶ Cf. *Li Yongjun*, 18; also see *STÜRNER*, 8.

⁷⁷ *Li Yongjun*, 17.

administrative and criminal law may apply as well. Probably the legislator chose to include these provisions in order to highlight the completeness of the system of legal protection.⁷⁸

There is some need for clarification with respect to art. 33. Firstly, it remains unclear **41** which authority or court is competent to confirm the attribution or contents of a real right upon the interested party's request. Secondly, bearing in mind the principle of legal prescription of real rights (*supra* at 34), the question arises how there can be a dispute with respect to the contents of a real right. A possible explanation is that "contents" in this context refer to more case-specific parameters such as the amount of claims secured by a charge.⁷⁹

3. Statute of Limitation

Finally, the Law leaves open the question whether the real right claims under arts. **42** 34 and 35 RRL are subject to a statute of limitations (诉讼时效).⁸⁰ The statute of limitations is governed by arts. 135 to 141 GPCL and applies to all civil rights. The right to demand the return, removal of impairment, or elimination of hazard under arts. 34 and 35 constitutes "a special relationship of rights and obligations resulting from legal provisions" within the meaning of art. 84 para. 1 GPCL. Therefore, such a right qualifies as a civil right within the meaning of the GPCL⁸¹ and is thus subject to limitation of actions. However, a statute of limitations does not apply in cases of infringement of property of the state unless such property is under authorised operation and management by an individual or a legal person.⁸²

Consequently, a party may only apply to a people's court for protection of its real **43** rights claims within two years' time after such party has or should have become aware of the infringement upon its rights⁸³, as well as of the identity of the infringer⁸⁴. In addition, no protection will be granted if 20 years have passed since

⁷⁸ *BU Xianghong* (2011), 63; also cf. *LIU Baoyu*, 24 (right column).

⁷⁹ *LI Yongjun*, 18, 19.

⁸⁰ *LIU Baoyu*, 24 (right column).

⁸¹ *TANG Dehua/GAO Shengping*, 1007, give the claim for return of property as an example of a civil right within the meaning of the GPCL.

⁸² Cl. 170 of the Opinions of the SPC on Several Issues concerning the Implementation of the GPCL of the People's Republic of China (For Trial Implementation).

⁸³ Arts. 135, 137 GPCL.

⁸⁴ *TANG Dehua/GAO Shengping*, 3158.

the infringement, irrespective of whether the entitled person has become aware of the infringement.⁸⁵

XI. Possession: Concept and Types

- 44** The last chapter of the RRL deals with possession. Its five articles (arts. 241-245) do not include a definition of possession. Possession within the framework of the RRL means the state of factual control over a thing;⁸⁶ and it exists independently from a right to possession.⁸⁷ Therefore, possession can occur in the form of rightful possession or unauthorised possession. Rightful possession can be based either on a real right, in particular, ownership, but also on usufructuary rights such as a pledge or lien⁸⁸, or on a contractual right⁸⁹ to possession.⁹⁰ As far as unauthorised possession is concerned, a distinction can be drawn between *mala fide* possession and *bona fide* possession according to whether or not the possessor knows, or should know, that he is not an authorised possessor.
- 45** Pursuant to art. 68 para. 1, an enterprise as a legal person has the right to possess its movable and immovable property. This shows that the RRL acknowledges that not only natural persons but also legal persons are able to exert control over a thing that is necessary for possession. As a legal person itself is incapable of acting, its management⁹¹ must act on the legal person's behalf, which includes exerting factual control over the things that the legal person possesses.

XII. Protection of Possession

46 1. Restitution/Elimination of Interference

Art. 245 RRL provides for the protection of possession in the following ways: (1) in cases of encroachment, the possessor is entitled to request the return of the property. In addition, (2) the possessor is entitled to request the elimination of any interference or hazard. This protection does not only apply to rightful possession but

⁸⁵ Art. 137 GPCL.

⁸⁶ *Sui Pengsheng*, 86.

⁸⁷ *Bu Xianghong* (2010), 94 (left column).

⁸⁸ *Bu Xianghong* (2011), 64.

⁸⁹ Cf. Art. 241 RRL. Examples include lease, freight transport, or deposit contracts (arts. 212, 304, 365 CL).

⁹⁰ *Sui Pengsheng*, 86, 87.

⁹¹ For details cf. *WERTHWEIN*, at 32, 63.

also to unauthorised possession.⁹² The reason for this is that the purpose of protection of possession is not restricted to safeguarding the rightful interests of an individual. Rather, it also aims to preserve public order.⁹³

A possessor is not entitled to self-help but has to seek protection of his interests with the courts. If the possessor fails to exercise his right to demand return of the property within one year, such a right will extinguish.⁹⁴ When the possessor is the owner of the property, he also has the right to demand return of it under art. 34 RRL, which is not subject to such a time limit.⁹⁵ **47**

2. Compensation

In addition to the above, art. 245 RRL succinctly states that where an encroachment or interference causes damage, the possessor has the right to request compensation. It has to be noted, however, that this provision is merely aimed at highlighting the completeness of the system of legal protection rather than setting out the full prerequisites of such a claim for compensation.⁹⁶ As this compensation claim ultimately is of a tort law nature, it will only arise if the requirements set out in arts. 2, 3 and 6 Tort Law ⁹⁷ are met.⁹⁸ **48**

A compensation claim under art. 245 will only arise if and to the extent that the value of the property has been reduced as a result of the encroachment or other interference. By contrast, damages cannot be claimed on the grounds that the (original) possessor was barred from using the property or from obtaining profits from the property during the time of the encroachment or other interference.⁹⁹ **49**

Furthermore (and in contrast to the claims for restitution and elimination of interference), only a possessor who has the right to dispose of the property is entitled to request compensation for a reduction of the value of the property. This **50**

⁹² *Sui Pengsheng*, 92.

⁹³ *Bu Xianghong* (2010), 95 (left column); *Sui Pengsheng*, 91.

⁹⁴ Art. 245 para. 2 RRL.

⁹⁵ However, this does not mean there is no time limit at all, see *supra* at 42, 43.

⁹⁶ *Bu Xianghong* (2011), 63.

⁹⁷ For details see *supra* Chapter 10 at 28.

⁹⁸ *Bu Xianghong* (2011), 63. *ZHANG Yuxin* (2010b), 113 (right column), also argues in favor of the protection of possession by the provisions of the Tort Law.

⁹⁹ *Bu Xianghong* (2011), 64, 65.

means that such claim only applies when the original possessor is the owner of the property or is entitled to it under a pledge or lien.¹⁰⁰

XIII. Claims against the Possessor

- 51** When a possessor is entitled to possess the property under a contract, the use of the property, the benefits therefrom and any breach of duty are primarily governed by the respective contract.¹⁰¹
- 52** If the possessor lacks entitlement to possess, the owner will have the right to request the possessor to return the property and the fruits therefrom. However, if the possessor was in good faith with respect to his entitlement to possess (i.e. he was unaware of his lack of entitlement for reasons other than gross negligence), the owner will have to compensate the possessor for his expenses necessary for maintaining the property.¹⁰² It has to be noted that the possessor is not entitled to compensation for any and all expense on the property but only for necessary expenses. In addition, the RRL does not grant the possessor a right of retention, so the possessor will have to return the property even if he has not yet been compensated for his necessary expenses.
- 53** An unauthorised possessor who is in bad faith with respect to his lack of entitlement to possess (i.e. who knows or should know that he has no right to possess the property) will be liable for compensation if he causes damage to the property in the use of it.¹⁰³ In contrast to the claim for compensation under art. 245 RRL (*supra* at 47), no additional (tort law) requirements need to be met¹⁰⁴ as the requirement of bad faith under art. 243 is sufficient to justify the possessor's liability.
- 54** Finally, art. 244 RRL provides for subrogation of insurance monies, compensation payments, or indemnities received by the possessor due to impairment or loss of the property. Such subrogation applies to any situation where the possessor is obliged to pay compensation, i.e. to an unauthorised possessor (who, if he was in bad faith, will remain liable for damages not covered by the subrogated monies), as well as to a rightful possessor.

¹⁰⁰ *Bu Xianghong* (2011), 65.

¹⁰¹ Art. 241 RRL.

¹⁰² Art. 243 RRL.

¹⁰³ Art. 242 RRL.

¹⁰⁴ Cf. *Li Yongjun*, 19.

Chapter 14. Acquisition of Ownership

Literature: *BU Yuanshi* (卜元石), Introduction to Chinese Law (Einführung in das Recht Chinas), Munich 2009. *CHENG Xiao* (程啸), On the Constitutive Conditions of Bona Fide Acquisition of Immovable Property (论不动产善意取得之构成要件), Studies in Law and Business (法商研究) 2010, No. 5, 74-84, cited as *CHENG Xiao* (2010a). *CHENG Xiao* (程啸), On the Differentiation Between Public Reliance on the Land Register and Bona Fide Acquisition of Movable Property (论不动产登记簿公信力与动产善意取得的区分), Peking University Law Journal (中外法学) 2010, No. 4, 524-539, cited as *CHENG Xiao* (2010b). *DONG Xueli* (董学立), On the New Mode of Real Right Transaction Established by the Chinese Real Rights Law (论《物权法》确立的物权变动新模式), Legal Forum (法学论坛) 2011, No. 4, 54-64. *JIA Lianjun* (贾连君), The Impact of the Principle of Separation in Real Right Transactions on Notarization (物权变动区分原则对公证业务的影响), China Notary (中国公证) 2009, No. 8, 42-44. *LI Yongjun* (李永军), Reflections on the First Part of the Real Rights Law (对《物权法》第一编的反思), Contemporary Law Review (当代法学) 2010, No. 2, 7-20. *LIU Baoyu* (刘保玉), The Achievements and Shortcomings of China's Real Rights Law (中国物权法的成就与不足), Legal Forum (法学论坛) 2008, No. 5, 21-28. *LU Chunyu* (鲁春雅), On Moment of Bona Fide in Bona Fide Acquisition of Real Estate (论不动产善意取得制度中善意判断的时点), Legal Forum (法学论坛) 2011, No. 3, 130-135. *LURGER/FABER*, Principles of European Law – Acquisition and Loss of Ownership of Goods, Munich/Berne 2011. *STÜRNER*, The New Chinese Real Rights Law from a German Perspective (Das neue chinesische Sachenrecht aus deutscher Sicht), in: *BU Yuanshi* (卜元石) (ed.), Chinese Civil and Commercial Law from a German Perspective (Chinesisches Zivil- und Wirtschaftsrecht aus deutscher Sicht), Tübingen 2008, 3-17. *SUI Pengsheng* (隋彭生), On the Right of Possession (论占有之本权), Studies in Law and Business (法商研究) 2011, No. 2, 86-95. *TANG Dehua* (唐德华)/*GAO Shengping* (高圣平) (ed.), New Commentary on the General Principles of Civil Law and Additional Provisions (民法通则及配套规定新释新解), 2nd edition, Beijing 2003. *TU Changfeng* (涂长风), Secured Transactions, in: *BU Yuanshi* (卜元石) (ed.), Chinese Business Law, Munich 2010, 183-219. *WANG Rongzhen* (王荣珍), On Bona Fide Acquisition of Priority Notice Registration (论预告登记的善意取得), Law Science Magazine (法学杂志) 2011, No. 3, 10-13. *WANG Yi* (王轶), On Chinese Elements in China's Civil Legislations (论中国民事立法中的“中国元素”), Law Science Magazine (法学杂志) 2011, No. 4, 27-32. *ZHANG Yuxin* (张喻忻), On the Possession System of Property Law in the Traditional Legal Culture (传统法律文化中的物权法占有制度探析), Hebei Law Science (河北法学) 2010, No. 3, 116-120; cited as *ZHANG Yuxin* (2010a). *ZHENG Hui* (郑辉), Bankruptcy, in: *BU Yuanshi* (卜元石) (ed.), Chinese Business Law, Munich 2010, 221-268.

Acquisition of ownership occurs in form of original acquisition and derivative 1
acquisition. While original acquisition refers to the acquisition of ownership over an

asset which was not owned by anybody at the time of acquisition, derivative acquisition means acquisition from a predecessor in title. It should be noted that the object of acquisition is the ownership right over an asset rather than the asset itself.¹

- 2 According to art. 115 RRL, ownership over an accessory is transferred along with ownership over the principal thing, whereas (in cases of derivative acquisition) the parties may stipulate otherwise. The RRL does not define the term “accessory”. Under German law, accessories are movable things that, without being parts of the principal thing, are intended to serve the economic purpose of the main thing and are in a spatial relationship to it that corresponds to this intention.² There is good cause to believe that under Chinese law a similar concept applies.

I. Conveyance of Title

- 3 Conveyance of title, as addressed in this section, exclusively refers to derivative acquisition of ownership by virtue of contracts. Derivative acquisition of ownership by other means (such as acquisition by way of succession or as a result of continuous possession), as well as original acquisition (e.g. of fruits) will be dealt with in section III of this Chapter (*infra* at 61 *et seqq.*).

1. Transfer by a Single Legal Act

- 4 The parties to a transaction can accomplish conveyance of title by a single legal act. Typically, this will be a sales and purchase contract, which, pursuant to art. 130 CL, is a contract whereby the seller transfers his ownership over the targeted matter to the buyer and the buyer pays the price therefor.³ When the RRL sets out additional requirements such as delivery or registration (for details see *infra* at 8 *et seqq.*), such an additional act is of a factual nature (i.e. it is a “real act” as opposed to a legal act).⁴

¹ Cf. *DONG Xueli*, 54, note 5. A contrary approach (transfer of the asset itself) is taken by French law, under which the transfer of ownership takes place by extinction of the transferor's right and creation of a new right in favour of the acquirer (*LURGER/FABER*, 490).

² Art. 97 para. 1 of the German Civil Code (*Bürgerliches Gesetzbuch*).

³ This shows that under Chinese law there is one single contract containing an agreement on mutual obligations as well as an agreement on the actual transfer of both the targeted matter and the purchase price, cf. *STÜRNER*, 7.

⁴ *STÜRNER*, 8; *BU Yuanshi* 134 at 23. By contrast, *DONG Xueli*, 54 (left column), seems to be of the opinion that there must be a real agreement, or declaration of a “real right will (物权意思)” because art. 15 RRL sets out the “principle of separation (区分原则)”, which *DONG* obviously associates with the

The German approach has not found its way into the RRL although Chinese 5 scholars had discussed it for many years before the enactment of the RRL.⁵ Under the German model, a sales and purchase contract only creates an obligation to a title transfer and will on no account bring about a transfer of title by itself, whereas the transfer of title can only be effected by a second legal act, the so-called “real agreement” (物权行为)⁶. The two legal acts exist separately from one another (principle of separation), and the legal validity of the real agreement is independent of the validity of the underlying sale and purchase contract (principle of abstraction 物权无因性).⁷ If such underlying contract is void or avoided, ownership will not be re-vested automatically, but the transferee has a duty to retransfer his ownership right over the property under the rules of unjust enrichment.⁸

Although Chinese law does not follow the German approach, there is a certain 6 degree of separation at the conclusion of a sales and purchase contract on the one hand from the actual transfer of ownership on the other hand. For immovable property, art. 15 RRL states that a contract with respect to the creation, alteration, transfer, or extinction of a real right takes effect immediately upon execution, irrespective of whether the property right has already been registered. For sales and purchase contracts, i.e. the transfer of ownership of immovable as well as movable property, art. 135 CL stipulates that the seller is obliged to deliver and transfer ownership over the targeted matter. These provisions show that a contractual obligation to transfer ownership can be validly created without the need for immediate transfer. It is not even necessary that the seller is the owner of the targeted matter at the time of the conclusion of the sales and purchase contract.⁹

“real agreement” under German law (for details on the German approach see the next paragraph). However, there is in fact no such close link between the Chinese principle of separation and the German approach (for the differences between Chinese and German law in this respect, see *infra* at 5-7). *Jia Lianjun*, 42, is under a similar misapprehension.

⁵ *BU YUANSHI*, 134 at 23.

⁶ Cf. *DONG Xueli*, 55 (left column).

⁷ These principles are referred to as 物权行为无因性 in Chinese (cf. *DONG Xueli*, 61 (left column)).

⁸ For a detailed description of the German model with respect to movable property, see *LURGER/FABER*, 409, 482-484. The distinctive feature of the German model is typically referred to as the “principle of separation and abstraction of the real agreement”, in Chinese: 物权行为与债权行为区分与无因原则 (cf. *Li Yongjun*, 18, note 1).

⁹ Art. 3 para. 1 of the Interpretation of the SPC on Issues Concerning the Application of Law in the Trials of Cases about Disputes over Sales and Purchase Contracts. This provision shows that arts. 132, 51 CL do not refer to the validity of the sale and purchase contract itself but rather to the validity of the transfer of title effected under such contract.

7 This separation of the contractual obligation from the completion of the transfer itself is merely a chronological one. While the RRL permits a delay in time between “signing” and “closing”, these two elements are closely linked to each other legally. If there is no valid contract, delivery alone will not make for a transfer of title. Some Chinese scholars refer to art. 15 RRL as containing the “principle of separation”¹⁰ or the “principle of separation of the validity of an obligatory contract and the transfer of a title”¹¹. This is correct as far as the chronological separation is concerned. However, one must bear in mind that the same term has a different meaning under German law (*supra*), so the use of this term in the context of Chinese law can be somewhat misleading.¹²

2. General Remarks on Publicity Requirements

- 8 Following the principle of publicity of real rights (*supra* Chapter 13 at 38), under Chinese law the transfer of ownership (as well as the establishment and transfer of any other real right) requires an act of publicity. Usually the transfer of ownership of movable property only takes effect upon delivery, and the transfer of ownership of immovable property does not become valid before registration.¹³ This shows that Chinese law has not adopted the model of transfer by mere consent¹⁴ as its basic model. Exceptions will be discussed below (at 10 *et seqq.*).
- 9 As mentioned above (*supra* at 4), the act of publicity is of a factual nature. The act of publicity itself never causes the transfer of ownership; the validity of the transfer

¹⁰ DONG Xueli, 54 (left column); JIA Lianjun, 42.

¹¹ LIU Baoyu, 22 left column.

¹² Cf. *supra* note 4 for examples. It certainly contributes to the risk of confusion that the German principle of separation, just as the principle of separation under Chinese law, allows for a chronological separation of the obligatory contract from the actual transfer of title. However, this is not the key point under German law. The meaning of the principle of separation under German law is rather that the transfer in title requires a separate legal act (not just a “real act”) the legal validity of which, according to the principle of abstraction, has to be assessed irrespective of the legal validity of the underlying obligatory contract.

¹³ Arts. 6, 9 para. 1, and 23 RRL. This model is referred to as 债权形式主义 in Chinese (cf. WANG Yi, 29 (right column)).

¹⁴ In Chinese this model is referred to as 意思主义 (cf. WANG Yi, 30 (right column)). French law is a textbook example of transfer by mere consent. Under French law, the ownership of movable property passes on from the transferor to the transferee in the moment in which the contract, e.g. a sales and purchase contract, is validly concluded, and from such point in time a transferor who still holds the asset does so on account of the transferee (LURGER/FABER, 488).

always depends on the existence of a valid contract, e.g. a sales and purchase contract.¹⁵

3. Publicity Requirements Regarding Movable Property

a. Delivery

Pursuant to art. 23 RRL, conveyance of title in movable property requires the 10 delivery of the movable property, unless the law provides otherwise. Such other provisions are contained in arts. 25-27 RRL. When a transferee has already lawfully possessed the movable, e.g. as a lessee, prior to the conclusion of the contract that is targeted at the transfer of ownership, ownership validly passes on to the transferee at the time when such a contract becomes effective;¹⁶ no delivery is required (*brevi manu traditio* 简易交付¹⁷).

Under arts. 26 and 27 RRL, actual delivery (实际交付)¹⁸ (or physical delivery) can 11 be substituted by notional delivery (观念交付).¹⁹ This means that direct (or actual) possession of the movable property remains with the same person, while a change only takes place on the level of indirect (or constructive) possession. As a result, the principle of publicity is attenuated in very much the same way as in German law.²⁰

When a third party possesses the property, the transferor may discharge his 12 obligation to deliver the property by transferring to the transferee the right to request the third party to return the property.²¹ The transfer of ownership is complete as soon as the transfer of the right to request a return of the property becomes effective.²² It is noteworthy that such a right to request a return must be the result of

¹⁵ STÜRNER, 7.

¹⁶ Art. 25 RRL. The beginning of this provision (“The establishment and transfer of real rights in movable property (...)”) addresses both the transfer of ownership and the establishment of other real rights (such as a pledge). However, its last part (“(...) the real right shall become effective as of (...)”) strictly speaking, only fits the establishment of real rights, cf. *LIU Baoyu*, 26 (right column).

¹⁷ Cf. *SUI Pengsheng*, 91.

¹⁸ Cf. *SUI Pengsheng*, 91.

¹⁹ Cf. *LIU Baoyu*, 26 (left column); *SUI Pengsheng*, 91.

²⁰ STÜRNER, 11.

²¹ Art. 26 RRL. This kind of substitution of actual delivery is termed 指示交付 in Chinese, cf. *LIU Baoyu*, 26 (left column); *SUI Pengsheng*, 91.

²² Where the right to request return of the property is transferred by way of transfer of a delivery order (提货单), the transfer does not become effective before the third party possessor has been notified of the transfer. See *Concordia Agricultural Products (Shanghai) Ltd. v Guangdong Fuhong Oil Products Ltd and Zhanhong Branch of China Construction Bank Co., Ltd.* as third party in respect of a dispute over the confirmation of ownership (肯考帝亚农产品贸易(上海)有限公司与广东富虹油品有限公司、第三

lawful possession by the third party, so a claim arising from unjust enrichment will not be sufficient.

- 13** When the transferor possesses the movable property, the transferee may agree that the property remains in possession of the transferor after the transfer of ownership of the property (*constitutum possessorium* 占有改定²³).²⁴ The parties have to make an explicit agreement to this effect, e.g. a lease agreement between the transferee as lessor and the transferor as lessee; the agreement on the transfer of ownership itself, e.g. a sale and purchase contract, is not sufficient.²⁵ Ownership passes on to the transferee upon conclusion of both agreements.

b. Registration

- 14** Registration is not only available for real rights over immovable property (see *infra* at 18 *et seqq.* for registration of immovable property) but also for certain types of movable assets. Pursuant to art. 24 RRL, the establishment, modification, transfer and lapse of real rights in respect of vessels, aircraft vehicles, and motor vehicles does not affect a *bona fide* third party before such establishment, modification, transfer, or lapse of a real right has been registered.²⁶
- 15** It is clear that after the delivery of a vessel, aircraft vehicle, or motor vehicle, the transfer of title needs to be registered in order to be effective as against a *bona fide* third party.²⁷ However, the question arises whether delivery is still required to complete the transfer of ownership when the transfer has already been registered. Given that the purpose of any act of publicity is to make the transfer visible to the public one could argue that registration serves this purpose as well as, or even

人中国建设银行股份有限公司湛江市分行所有权确认纠纷案), judgement of the SPC dated 25th February, 2011. Unlike a bill of lading (提单, see art. 71 of the Maritime Code (*infra* note 29)), a delivery order is not a document of title.

²³ Cf. *Liu Baoyu*, 26 (left column); *Sui Pengsheng*, 91.

²⁴ Art. 27 RRL. Similar to art. 25, the wording of art. 27 is imperfect in that the Law addresses the transfer of a real right but states that such real right “shall become effective”, cf. *Liu Baoyu*, 26 (right column).

²⁵ *Qingdao Yuanhongxiang Textile Co., Ltd. v Gangrun (Liaocheng) Printing and Dyeing Co., Ltd.* in respect of a dispute over the confirmation of a recall right (青岛源宏祥纺织有限公司诉港润(聊城)印染有限公司取回权确认纠纷案), judgement of the High People’s Court of Shandong Province dated 5th May, 2011.

²⁶ There are separate registers for the different types of assets. For example, the registration of real rights with respect to vessels is subject to the Regulations on Vessel Registration (船舶登记条例) promulgated on 2nd June, 1994 and effective from 1st January, 1995. Registers are run by the local offices of the Maritime Safety Administration (海事局); a central register does not exist.

²⁷ For details regarding the concept of opposability against a *bona fide* third party, see *infra* at 20.

better than, delivery can do;²⁸ therefore, no delivery should be required in this case. In addition, the transfer of ownership of immovable property solely requires registration as an act of publicity. Therefore, one could take the view that art. 24 RRL is a “law that provides otherwise” within the meaning of art. 23 RRL.

On the other hand, art. 6 RRL clearly states that the establishment and transfer of 16 real rights over movable property require delivery of the property. Art. 16 RRL, according to which registration is the basis for the attribution of real rights, only applies for immovable property. In addition, it would be odd if the generic reference to the possibility of exceptions in art. 23 RRL were directly followed by a provision containing such an exception without art. 23 pointing to it in a more specific way. More importantly, arts. 25 and 27 RRL give an example of how the RRL is worded when transfer can take full effect in the absence of actual delivery (“the real right shall become effective”). By contrast, art. 24 RRL only refers to opposability as an option against a *bona fide* third party.

In summary, although it would make sense if delivery were not required once 17 registration had already been inacted, the RRL clearly indicates that delivery is required even in such circumstances.²⁹ This understanding is also backed by art. 10 no. 4 of the Interpretation of the SPC on Issues Concerning the Application of Law in the Trial of Cases about Disputes over Sales and Purchase Contracts.³⁰

4. Publicity Requirements Regarding Immovable Property

While for real rights over movable property registration is an exception, for real 18 rights over immovable property registration is the rule (art. 9 para. 1 RRL). The only kind of real right over immovable property that is entirely independent of registration is the state’s ownership of natural resources that belong to the state according to the

²⁸ This idea seems to be at the basis of art. 106 para. 1 no. 3 RRL according to which good faith acquisition does not require delivery where a real right that requires registration has been duly registered.

²⁹ WANG Yi, 30/31 also holds the view that the transfer of title in vessels, aircraft vehicles and motor vehicles requires both delivery and registration to be effective against a *bona fide* third party. However, the argument put forward by WANG that this “mixed approach” (混合主义) is backed by the relevant provisions of the Maritime Code and the Civil Aviation Law is not a perfectly cogent one. Both art. 9 para. 1 of the Maritime Code (海商法, promulgated on 7th November, 1992 and effective from 1st July, 1993) and art. 14 para. 1 of the Civil Aviation Law (民用航空法, promulgated on 30th October, 1995 and effective from 1st March, 1996; last revision effective from 27th August, 2009) refer to registration exclusively and do not mention delivery at all.

³⁰ For details see *infra* at 32 *et seqq.*

law³¹ (which obviously will never be the object of a conveyance of title). Since only the state and the collectives can own land,³² the only kind of immovable property that can be under private ownership is buildings. Ownership of land is functionally substituted by land use rights (which will be dealt with in Chapter 16).

- 19** The Law differentiates as to the effect of registration of a real right. For some real rights, registration is a prerequisite for the real right to come into effect, whereas other real rights become effective upon the conclusion of the contract; the only effect of a lack of registration being that such right may not be used against a *bona fide* third party (“validity upon publicity” (公示生效主义) vs. “opposability upon publicity” (公示对抗主义)³³).³⁴
- 20** The concept of opposability against a *bona fide* third party originates from Japanese law.³⁵ It does not refer to any third party but only to a third party that has a legitimate interest in the property over which the real right was established. While under Japanese law even a lessee may fall within the scope of the concept of the *bona fide* third party,³⁶ there is good reason to believe that under Chinese law, a *bona fide* third party simply means an “acquirer in good faith”.³⁷
- 21** For example, when a charge over movable property has not been registered, the charge is effective for the chargor, the chargee, and their creditors. Therefore, the chargee’s right to satisfy his claim from the property ranks senior to any claims of the chargor’s other creditors. However, if the chargor sells the property to a third
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- ³¹ Arts. 9 para. 2, 48 RRL.
- ³² *Supra* Chapter 13 at 27.
- ³³ Cf. *DONG Xueli*, 54 (left column).
- ³⁴ “Validity upon publicity” applies to the right to the use of construction land (arts. 139, 145 RRL), to charges over buildings, over the right to the use of construction land, over the right to barren land which was contracted by the chargor by way of bidding, auction, or open consultation, and over buildings under construction (arts. 187, 180 para. 1 nos. 1, 2, 3 and 5 RRL), and to pledges over movable property or over rights. “Opposability upon publicity” is, for example, applicable for the transfer or exchange of a right to land contractual management (art. 129 RRL), for easement (art. 158 RRL) and for charges over movable property, means of transportation, and vessels or aircrafts (arts. 188, 180 para. 1 nos. 4-6 RRL). For a detailed survey see *Bu Yuanshi*, 133.
- ³⁵ *Li Yongjun*, 14. *DONG Xueli*, 62/63, gives a brief outline of the debate as to the exact meaning of the concept of a “third party” under Japanese law.
- ³⁶ *Bu Yuanshi*, 132 at 20.
- ³⁷ *DONG Xueli*, 62 (right column). This limitation in scope is supported by the use of the term “*bona fide* third party” rather than simply “third party”, which shows that the RRL only refers to such a third party whose good faith is legally relevant, e.g. under arts. 106 or 108 RRL. The provisions of Chinese law on lease contracts (arts. 212-236 CL) do not provide for the protection of a *bona fide* lessee. Rather, where the lessee cannot use the leased object because of a third party’s claim, he is only entitled to demand a reduction of the rent (art. 228 para. 1). Therefore, a lessee does not fall within the scope of the concept of *bona fide* third party under Chinese law.

party who is in good faith with respect to the existence of the charge, i.e. who is neither aware nor ought to be aware of its existence, such a third party will acquire unencumbered ownership of the property.³⁸

5. Dualistic Function of Registration

As a basic rule, where registration of a real right in immovable property is available, **22** such registration is a prerequisite for the real right to come into effect.³⁹ As an exception to this, for a number of real rights in immovable property, as well as for real rights in movable property where these can be registered, registration is only necessary for the real right to be opposable against a *bona fide* third party.

This exception has been criticized as the “greatest deficiency of the RRL”⁴⁰. One of **23** the reasons adduced for this harsh criticism is that the concept of “opposability upon publicity” conflicts with the principle of publicity, in particular with art. 16 RRL, according to which the register of immovable property provides the basis for the attribution and contents of real rights.⁴¹ Furthermore, it seriously challenges the principle of absoluteness of real rights.⁴²

On the other hand, it is argued that the concept of “opposability upon publicity” **24** should not have been restricted to registration as a means of publicity but should have been extended to publicity by delivery. More precisely, the RRL should stipulate that in cases of notional delivery (*supra* at 11), the real right cannot be opposed against a *bona fide* third party before actual delivery of the property.⁴³

At any rate, the mere existence of the dualism⁴⁴, or double-track system⁴⁵, with **25** respect to the function of registration, as outlined above, can appear quite confusing.⁴⁶ Hence, a good argument can be made that this dualism should be abolished⁴⁷ or reduced to the largest extent possible.

³⁸ Example adopted from *Bu Yuanshi*, 132 at 20.

³⁹ Art. 9 para. 1 RRL; also cf. *DONG Xueli*, 54 (left column).

⁴⁰ *Li Yongjun*, 12

⁴¹ *Li Yongjun*, 14.

⁴² *Li Yongjun*, 15.

⁴³ *Liu Baoyu*, 26 (left column). A similar result is achieved by arts. 933 and 934 of the German Civil Code (*Bürgerliches Gesetzbuch*).

⁴⁴ *Liu Baoyu*, 12; *DONG Xueli*, 54 (left column).

⁴⁵ *Liu Baoyu*, 12.

⁴⁶ *STÜRNER*, 11.

⁴⁷ *STÜRNER*, 12.

6. Retention of Title

- 26** Pursuant to art. 134 CL, the parties to a sales and purchase contract may agree that ownership over the targeted matter remains with the seller until the buyer has performed his obligations under the contract, which will typically be the payment of the purchase price. Under such retention of title, the seller delivers the targeted matter to the buyer right away, and the buyer becomes the owner of the targeted matter upon payment. While the conclusion of a sales and purchase contract and subsequent delivery of the targeted matter would usually be sufficient to effect the transfer of title, the retention of title arrangement enables the seller to deliver his property to the buyer without running the risk of losing ownership to the buyer before the price is paid.
- 27** Art. 134 CL does not apply to sales and purchase contracts over immovable property, which is clarified by art. 34 of the Interpretation of the SPC on Issues Concerning the Application of Law in the Trial of Cases about Disputes over Sales and Purchase Contracts (hereinafter: SPC Purchase Contract Interpretation). This is because the problem that the retention of title mechanism aims to solve, i.e. the seller's risk to lose ownership by delivering the targeted matter to the buyer, does not exist in cases of immovable property, because for a transfer of title for an immovable property registration rather than delivery is required.⁴⁸
- 28** Although the seller remains the owner of the targeted matter until the buyer has performed his obligations under the contract, the seller is not entitled to demand a return of the targeted matter under art. 34 RRL. The reason is that under the retention of title agreement the seller grants the buyer a right to possess the targeted matter even before the performance of the buyer's duties. However, the situation will change if the buyer causes harm to the seller by failing to pay the purchase price as scheduled, failing to fulfill any other contractual conditions as agreed on, or by disposing of the targeted matter without being authorised to do so.

⁴⁸ Cf. the interview of the official in charge of the second civil division of the SPC by the People's Court Daily in respect of the SPC Purchase Contract Interpretation, available at http://www.court.gov.cn/xwzx/yw/201206/t20120606_177337.htm.

In this case, the seller may claim back the targeted matter in accordance with art. 35 para. 1 SPC Purchase Contract Interpretation.⁴⁹

The seller will not be entitled to claim back the targeted matter if the buyer has already paid 75 per cent or more of the total purchase price.⁵⁰ The same applies if as a result of the buyer's unauthorised disposal of the targeted matter, a third party has acquired ownership or another real right over the targeted matter in good faith.⁵¹ The author believes that this second provision is going too far. Where a third party has only acquired a (non-possessory) charge on the targeted matter, it can be returned to the seller without any impact on the encumbrance. However, it remains to be seen how this will be handled in judicial practice.

When the seller has recovered the targeted matter, he may not readily sell it to a third party. Rather, he may only do so if the buyer fails to eliminate the reason that entitled the seller to take back the targeted matter within the redemption period (as agreed between the parties or as determined by the seller),⁵² e.g. by paying the outstanding amount of the purchase price. The proceeds of a sale to a third party by the seller are used to cover (1) the expenses for the recovery and storage of the targeted matter, (2) the expenses for the sale to a third party, (3) interest, and (4) the outstanding amount of the purchase price. The remaining amount, if any, has to be passed on to the original buyer. If the proceeds do not fully cover the outstanding amount of the purchase price, the original buyer will have to pay the outstanding amount, except when he is able to prove the targeted matter was sold to the third party clearly below market price.⁵³

Financial difficulties might of course also arise on the part of the seller, instead of the buyer. If the seller becomes insolvent before the buyer has paid the (full)

⁴⁹ This is in contrast to art. 94 no. 3 CL, under which the contract may only be terminated if the defaulting party fails to perform its duties within a reasonable period of time after the other party issued a warning notice. The SPC Purchase Contract Interpretation does not require such warning notice but only provides for a mechanism similar to the warning notice after the seller has recovered the targeted matter (see *infra* at 30). For retention of title, the SPC Purchase Contract Interpretation prevails over art. 94 CL as it constitutes the *lex specialis*, as well as the *lex posterior* in relation to the CL.

⁵⁰ Art. 36 para. 1 SPC Purchase Contract Interpretation. Art. 155 GPCL clarifies that in civil law the expression “以上”, which is used in art. 36 para. 1 SPC Purchase Contract Interpretation, includes the given figure. Therefore, it will be sufficient if the buyer has paid exactly 75 per cent of the purchase price.

⁵¹ Art. 36 para. 2 SPC Purchase Contract Interpretation. For details on acquisition of real rights in good faith, see *infra* at 91 *et seqq.*

⁵² Art. 37 paras. 2, 1 SPC Purchase Contract Interpretation.

⁵³ Art. 37 para. 3 SPC Purchase Contract Interpretation.

purchase price, the buyer may wish to obtain ownership over the targeted matter by paying the outstanding part of the purchase price to the seller's administrator, particularly when the buyer has already paid a large part of the purchase price (but less than the 75 per cent required under art. 36 para. 1 SPC Purchase Contract Interpretation⁵⁴). The existence of such a possibility would mean that the retention of title separates the targeted matter from the seller's insolvency estate for the benefit of the buyer, so that the other creditors of the seller cannot access the targeted matter if the buyer chooses to pay the outstanding part of the purchase price. However, it remains unclear whether under Chinese law such a separation mechanism exists, and if so, whether it is of a real right nature rather than based on the law of obligations.⁵⁵

7. Multiple Sale

- 32** As it is possible to conclude multiple sales and purchase contracts on the same targeted matter⁵⁶ the question arises which of the buyers shall eventually become the owner of the targeted matter. In case of ordinary, i.e. non-registrable, movable property, this will be the buyer to whom the targeted matter has already been delivered; if the seller has not yet delivered the targeted matter, the buyer who has already paid the purchase price may demand delivery of the targeted matter; and when neither delivery nor payment has been effected, the buyer who was the first to enter into a sales and purchase contract is entitled to demand delivery of the targeted matter.⁵⁷
- 33** This rank order (delivery – payment – priority of the conclusion of the contract) is slightly modified for vessels, aircrafts, and motor vehicles. As real rights over these kinds of movable property need to be registered in order to be opposable to a *bona fide* third party,⁵⁸ the element “payment” is replaced by the element “registration”. Therefore, a buyer to whom the targeted matter has already been delivered is entitled to demand registration; if the seller has not yet delivered the targeted matter,

⁵⁴ Cf. *supra* at 29.

⁵⁵ *BU YUANSI*, 143 at 51. For the reverse scenario (insolvency of the buyer) see *ZHENG Hui*, 250/251 at 120.

⁵⁶ Cf. art. 15 of the Interpretation II of the SPC of Several Issues concerning the Application of the Contract Law of the People's Republic of China and *supra* at note 9.

⁵⁷ Art. 9 SPC Purchase Contract Interpretation.

⁵⁸ Cf. *supra* at 14 *et seqq.*

the buyer whose ownership has already been registered⁵⁹ may demand delivery of the targeted matter. In the absence of both delivery and registration, the buyer who was the first to enter into a sales and purchase contract is entitled to demand delivery of the targeted matter and registration of his ownership.⁶⁰ When the targeted matter has been delivered to one buyer, but another buyer has been registered, the former may demand to be registered as the owner.⁶¹

A buyer who, as a result of the application of the above provisions, eventually does not become the owner of the targeted matter is entitled to claim damages from the seller.⁶² The SPC Purchase Contract Interpretation does not govern multiple sale of immovable property. This is because a buyer of immovable property can use the instrument of priority notice registration (art. 20 RRL) in order to ensure that he will acquire ownership of the targeted matter even in cases of a multiple sale^{63,64} In the absence of a priority notice registration, the buyer who is the first to obtain an enforceable judgement against the seller will win the race.

II. Acquisition in Good Faith

In general, ownership (as well as any other real right) over property can only be acquired from a person who has the power to dispose of the property.⁶⁵ As an exception to this rule, art. 106 RRL sets out conditions under which real rights⁶⁶ can

⁵⁹ It is unlikely that this second scenario will occur in practice with regard to motor vehicles. Pursuant to arts. 7 para. 1 and 19 para. 1 of the Provisions on Motor Vehicle Registration (机动车登记规定, promulgated on 27th May, 2008 and effective from 1st October, 2008), the (new) owner who applies to be registered as the owner is required, *inter alia*, to hand over the motor vehicle to the registration authority for inspection.

⁶⁰ Art. 10 nos. 1-3 SPC Purchase Contract Interpretation.

⁶¹ Art. 10 no. 4 SPC Purchase Contract Interpretation.

⁶² Art. 15 of the Interpretation II of the SPC of Several Issues concerning the Application of the Contract Law of the People's Republic of China.

⁶³ Cf. the interview of the official in charge of the second civil division of the SPC by the People's Court Daily in respect of the SPC Purchase Contract Interpretation, available at http://www.court.gov.cn/xwzx/yw/201206/t20120606_177337.htm.

⁶⁴ The Interpretation of the SPC on the Relevant Issues concerning the Application of Law for Trying Cases on Dispute over Contract for the Sale of Commodity Premises (hereinafter: SPC Commodity Premises Interpretation) in its art. 8 no. 2 only addresses the question of damages, but not the question which of several buyers shall become the owner. (The term "commodity premises" refers to uncompleted housing sold by real property developers to the public, cf. art. 1 of the SPC Commodity Premises Interpretation.)

⁶⁵ The underlying rule being that "no one gives what he does not have" (in Latin: *Nemo dat quod non habet*).

⁶⁶ Art. 106 RRL does not apply to priority notice registration under art. 20 RRL, i.e. a priority notice registration cannot be acquired in good faith, cf. *WANG RONGZHEN* (who advocates amending art. 20 RRL to the effect that art. 106 is declared applicable to priority notice registration).

be acquired in good faith, or *bona fide*, from a person who lacks the power to dispose of the property. Such protection of a *bona fide* acquirer obviously interferes with the rights of the original owner of the property. This interference is justified by the reduction of transaction costs (which *inter alia* consist of the need for an acquirer to look into the transferor's power of disposition), thus easing the circulation of property and the efficient allocation of resources. The original owner of the property is entitled to claim compensation for damages arising out of the good faith acquisition from the person disposing of the property without being entitled to do so.⁶⁷

36 *Bona fide* acquisition requires the acquirer's good faith with respect to the transferor's right of disposition over the property. Such good faith is based on the publicity of real rights. The acquirer's good faith can only overcome the transferor's lack of real rights over the property. Other defects, such as the transferor's lack of capacity for civil conduct,⁶⁸ cannot be cured by the fact that the acquirer has acted in good faith. Art. 106 para. 1 RRL reads, "When a person transfers to a transferee immovables or movables, which he has no right to dispose of, the owner shall have the right to recover them. Unless otherwise provided for by law, the transferee shall acquire ownership of the said immovables or movables under the following circumstances: (1) the transferee is in good faith when the said immovables or movables are transferred to him; (2) the transfer is made at a reasonable price; (3) the said immovables or movables have been registered when registration is required by law, or have been delivered to the transferee when no registration is required."

1. Good Faith

37 One could argue that according to the letter of the RRL an acquirer acts in good faith whenever he is not aware of the transferor's lack of power of disposition.⁶⁹ The prevailing view, however, is that for *bona fide* acquisition of both movable and immovable property such unawareness must not result from gross negligence on

⁶⁷ Art. 106 para. 2 RRL.

⁶⁸ A contract entered into by a party who lacks capacity for civil conduct (民事行为能力) is null and void, cf. art. 9 para. 1 CL. A lack of capacity for civil conduct may result from mental illness, cf. art. 13 para. 1 GPCL.

⁶⁹ STÜRNER, 12, note 30.

the acquirer's part.⁷⁰ Therefore, good faith acquisition is generally excluded not only when the acquirer actually knew, but also where he should have known of the transferor's lack of power of disposition.

For immovable property, registration is the basis for the attribution and content of real rights.⁷¹ Given that registration of real rights in state-run registers is a significantly more reliable means of publicity than possession,⁷² there are good arguments in favor of applying a different standard for good faith acquisition of immovable property than for movable property. Under such different standards, the acquirer would be in good faith when he relies on an entry in the register of immovable property showing the transferor's power of disposition, unless the acquirer has actual knowledge of the incorrectness of the register.⁷³

However, the RRL does not differentiate between good faith acquisition of real rights over movable property and over immovable property. There is a general assumption that the legislator has made this choice because of the deficiencies of China's system of registration of real rights over immovable property.⁷⁴ In particular, there are separate registers for land and for buildings, and registrations are not always accurate.⁷⁵

The acquirer must be in good faith at the time of the completion of the transfer. This means that both the required contract, e.g. a sales and purchase contract, and any legally required actions, i.e. "real acts", such as the registration of the real right or delivery of movable property, must be completed in good faith. If the acquirer gains knowledge of the transferor's lack of power to dispose of the property only after completion of the transfer, it will not have an effect on the transfer.

⁷⁰ CHENG Xiao (2010b), 537 note 53; BU YUANSHI, 141 at 45. Art. 108 RRL seems to support this interpretation of the concept of good faith in that it excludes *bona fide* acquisition of movable property free from encumbrance where the acquirer knew, or ought to have known of the encumbrance. TU Changfeng, 199 at 56, is of the opinion that an acquirer of a real security right does not act in good faith even when he is unaware of the security grantor's lack of power of disposition as a result of ordinary (not gross) negligence.

⁷¹ Art. 16 RRL.

⁷² CHENG Xiao (2010b), 537.

⁷³ CHENG Xiao (2010a), 80; CHENG Xiao (2010b), 537-539.

⁷⁴ CHENG Xiao (2010b), 533, takes the view that there is another reason why the legislator chose not to differentiate between movables and immovables. The situation with respect to publicity and transfer of rights to land contractual management (arts. 124 *et seqq.* RRL) is complicated (the majority of these rights are unregistered), and the legislator wanted to ensure that acquisition in good faith also applies to unregistered rights to land contractual management.

⁷⁵ Cf. CHENG Xiao (2010b), 532, 534.

41 The registration of a real right over immovable property can be a rather lengthy process. For example, the time limit within which the competent authority has to register ownership (or render a decision rejecting the application for registration) is thirty days from receipt of the application for buildings on state-owned land, and as much as sixty days for buildings on land owned by a collective.⁷⁶ Therefore, the idea has been put forward that it should be sufficient if the acquirer is in good faith at the time of the application for registration instead of the registration itself.⁷⁷ An exception should apply in cases where the register becomes incorrect only after the application has been filed, but before the registration is completed.⁷⁸ In such cases the acquirer would have to be in good faith at the point in time when the register becomes incorrect.⁷⁹ The prevailing view, however, requires that the acquirer is in good faith at the time of registration.⁸⁰

2. Reasonable Price

42 The second prerequisite for good faith acquisition is that the transfer takes place at a reasonable price. Whether a price is reasonable has to be determined by objective criteria,⁸¹ which will usually be established by reference to prices paid in comparable transactions. The creation of a contractual obligation to pay a reasonable price is not sufficient for *bona fide* acquisition. Instead, only an acquirer who has actually paid a reasonable price (either by single payment or in installments⁸²) deserves protection under the *bona fide* provision.⁸³

43 Again, the question arises whether real rights over movables and over immovables are to be treated alike. One could once more argue that the registration of real rights is more reliable a means of publicity than possession. Therefore, it should not matter whether the purchase price is reasonable if only the transfer does not take place gratuitously when the acquirer relies on a registration which speaks in favor of the

⁷⁶ Art. 23 para. 1 no. 1 of the Measures for Building Registration.

⁷⁷ *Lu Chunya*, 134 (left column).

⁷⁸ E.g. because the sales and purchase contract under which the transferor has previously acquired ownership is rescinded and therefore lacks binding force from the outset (arts. 54 and 56 CL).

⁷⁹ *Lu Chunya*, 134 (right column).

⁸⁰ Cf. *Lu Chunya*, 130 (left column); *CHENG Xiao* (2010a), 81. For real security rights also see *Tu Changfeng*, 198 at 56 note 101.

⁸¹ *CHENG Xiao* (2010a), 82.

⁸² Cf. *Tu Changfeng*, 199 at 57.

⁸³ *CHENG Xiao* (2010a), 83. The question arises why, unlike art. 189 para. 2 RRL, art. 106 para. 1 no. 2 does not explicitly stipulate that the “reasonable price” must have already been paid.

transferor.⁸⁴ More convincingly, it is pointed out that for immovable property there is no need for a reasonableness test for a different reason: the transfer of real rights will not be registered before the transferee has produced evidence that he has paid the deed taxes, whereas the tax assessment includes a reasonableness test run by the tax authority.⁸⁵ While the latter argument is likely to prove valid in most practical cases, strictly legally speaking, it is disputable whether the result of the tax authorities' reasonableness test can be binding for a civil court when adjudicating whether the civil law requirements for good faith acquisition have been met.

Unlike for the transfer of ownership of movable or immovable property, the 44
reasonability test is certainly not directly applicable to real security rights, which, pursuant to art. 106 para. 3 RRL, can also be acquired in good faith. Real security rights are usually granted without consideration. Rather, they serve as a basis for another transaction, such as a loan secured by the real security right. Therefore, the reasonableness test has to apply to the transaction as a whole, i.e. the question will be, for example, whether a loan is over-collateralized or not.⁸⁶

A person who acquires a real right at a price significantly below value without proper 45
reason should suspect that the transferor does not have the power to dispose of the respective property. If, in such a situation, the acquirer fails to look into the transferor's power to dispose, he will be likely found to have acted with gross negligence. According to the prevailing view regarding the criterion of good faith, such an acquirer therefore does not act in good faith. Consequently, the "reasonable price" requirement set out in art. 106 para. 1 no. 2 RRL strictly speaking does not add much to the good faith requirement contained in no. 1.⁸⁷ Nevertheless, no. 2 is to some extent relevant with regard to the question of burden of proof (*infra* at 48 *et seqq.*)

3. Publicity

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⁸⁴ WANG LIMING (王利明), Studies on Real Rights Law (revised edition) (物权法研究(修订版)) (volume 1), Beijing 2007, 446 (as cited by CHENG Xiao (2010a), note 49).
⁸⁵ CHENG Xiao (2010a), 82.
⁸⁶ TU Changfeng, 199 at 57. CHENG Xiao (2010a), 82, also expresses the view that the requirement of payment of a consideration cannot be mechanically applied to good faith acquisition of real security rights.
⁸⁷ Cf. BU YUANSHI, 141 at 45.

In addition to the requirements of good faith and payment of a reasonable price, the third prerequisite of *bona fide* acquisition is an act of publicity. When the acquisition from the actual owner would require registration, the same requirement applies for acquisition in good faith. In all other cases the object of the real right must be delivered to the acquirer, even when acquisition from the actual owner could, as under arts. 26 and 27 RRL, be accomplished without delivery.

- 47 Scholarly opinion is divided as to whether delivery suffices when registration is not required for the real right to become effective, but only for its opposability against a *bona fide* third party.⁸⁸ Given that the legislator wanted to ensure that acquisition in good faith can also apply to unregistered real rights over rural land⁸⁹ (such as the right to land contractual management), the preferable solution is that in accordance with the letter of the RRL delivery is sufficient.⁹⁰

4. Burden of Proof

- 48 As mentioned above, acquisition in good faith constitutes an exception to the principle that a real right can only be acquired from a person who has the power to dispose of the respective property. The structure of art. 106 para. 1 RRL reflects this principle in that the first sentence states that when a person disposes of property without having the power to do so, the rightful owner has the right to recover such property, whereas the second sentence sets out the requirements for good faith acquisition regardless of the transferor's lack of disposal power.
- 49 In light of the above, a person claiming to have acquired a real right in good faith would bear the burden to prove that the prerequisites of good faith acquisition are fulfilled. This view is supported by the fact that art. 106 RRL does not provide for a reversal of the burden of proof, "...except where the acquirer has not acted in good faith", "...unless the transfer is not made at a reasonable price", etc. instead of positively requiring that the acquirer has acted in good faith, has paid a reasonable price, etc.
- 50 However, as far as the acquirer's good faith is concerned it is the prevailing view that the original owner who reclaims his property under art. 106 para. 1 cl. 1 RRL

⁸⁸ Cf. CHENG Xiao (2010a), 83.

⁸⁹ CHENG Xiao (2010b), 533 at note 44.

⁹⁰ CHENG Xiao (2010a), 83.

has to prove that the acquirer has not been in good faith.⁹¹ This is the more workable solution as it is practically impossible for an acquirer to prove that he has not known, nor that he should have known of the transferor's lack of power to dispose. In addition, one might argue that in the majority of cases, the acquirer will be in good faith, whereas bad faith will be the exception. Finally, this solution also applies under other jurisdictions such as in German law.⁹²

All other prerequisites of good faith acquisition, i.e. payment of reasonable price and registration or delivery of the property, as the case may be, have to be proven by the acquirer who claims to have acted in good faith. To sum up, from a procedural point of view, in a first step the acquirer who is sued for return of the property to the original owner has to defend himself by proving payment of a reasonable price and delivery or registration, respectively. If he fails to do so, the court will grant the original owner's claim for return of the property. If the acquirer succeeds in proving the two points mentioned above, the original owner will have to prove that the acquirer has not acted in good faith, and if not, the court will dismiss the case. **51**

5. Lost Property

There are good reasons to limit or even exclude acquisition in good faith when the original owner has not given away his property intentionally and voluntarily, but has lost it. A person who gives away property, e.g. to a lessee or a depository, must realize that this creates the risk that the lessee or depository holds himself out as the owner of the property and transfers it to a third party. It therefore seems fair to burden the original owner with the risk of good faith acquisition by a third party. The situation is different with an owner who has lost his property. Since in such circumstances the owner has not voluntarily created the risk of good faith acquisition, it is justifiable from a legislator's view to restrict or exclude *bona fide* acquisition of lost property. **52**

It is somewhat unclear which approach applies under the RRL, i.e. whether art. 107 RRL completely excludes or merely limits *bona fide* acquisition of lost property. Art. 107 cl. 2 states the (original) owner's options when a party not entitled to dispose of **53**

⁹¹ Cf. *BU YUANSHI*, 141 note 100, with respect to immovable property *CHENG Xiao* (2010a), 80.

⁹² Art. 932 para. 1 of the German Civil Code (*Bürgerliches Gesetzbuch*) reads: "(...) the transferee becomes the owner even if the thing does not belong to the transferor, unless the transferee is not in good faith at the time when under these provisions he would acquire ownership. (...)".

the lost property⁹³ (e.g. the finder) transfers the possession of the property to a third party. In such circumstances, the owner may either claim damages from the finder or, within two years from the date he becomes, or ought to become, aware of the transferee, request the transferee to return the lost property. In the latter case, a transferee who has acquired the lost property by way of auction, or from a qualified seller, is only obliged to return the property upon reimbursement of the expenses he has paid for the property. If the original owner compensates the transferee for the expenses, he will be entitled to recover the payment he has made from the person who disposed of the lost property without being entitled to do so (art. 107 clause 3).

- 54** On the one hand, the RRL uses language supporting the view that for lost property, good faith acquisition does not apply at all.⁹⁴ In particular, art. 107 addresses the legal position acquired by the third party transferee as “possession” instead of “ownership”. In addition, the owner of the lost property is not referred to as its “original owner”, as in art. 106 para. 2, but rather as the “obligee”, i.e. a person who is still entitled to the property.
- 55** On the other hand, the right of the owner to recover lost property from any third party is already laid down in the first clause of art. 107, where such a right is neither subject to the two-year limitation of action as set out in art. 107 cl. 2⁹⁵, nor to the requirement of reimbursing the third party for its expenses for the property. The difference, therefore, must be that clause 1 contains the general rule with respect to lost property, whereas clause 2 refers exclusively to a situation where a *bona fide* third party subsequently acquired the lost property in accordance with art. 106. The restrictions added by clause 2 obviously aim at protecting a *bona fide* acquirer of lost property (as opposed to the finder or an acquirer of lost property who has not acted in good faith).
- 56** Moreover, if good faith acquisition of lost property were generally excluded, it would be unclear who shall be the owner when the original owner has lost his right to reclaim the lost property. The right to reclaim lost property under art. 107 cl. 2

⁹³ The term “lost property” implies that art. 107 RRL only applies to movable property as immovable property cannot be “lost”.

⁹⁴ This view is held by CHENG Xiao (2010b), 532, 533.

⁹⁵ In substance, however, there is no difference with respect to limitation of action as in the absence of a specific rule the general two-year limitation of action rule set out in art. 135 GPCL applies.

ceases to exist when the two-year time limit has expired⁹⁶ or the original owner has chosen to claim damages from the party who unauthorisedly disposed of the lost property. In addition, just like under art. 106 para. 2 RRL, such damage only arises when the original owner actually loses ownership as a result of the unauthorised disposal, which is only possible in cases of *bona fide* acquisition of ownership by a third party.

In light of the foregoing, the author believes that art. 107 RRL does not exclude *bona fide* acquisition of lost property. Instead, the legitimate interests of the original owner and of a *bona fide* transferee are protected and balanced in the following way: The original owner is not only entitled to demand compensation from the unauthorised transferor for his loss of ownership resulting from *bona fide* acquisition by a third party. Alternatively, he has the right to reclaim the property from the *bona fide* transferee, i.e. such transferee must transfer ownership back to the original owner. However, the latter claim is subject to two limitations that serve to protect the *bona fide* transferee. Firstly, there is a two-year time limit as discussed above. Secondly, a transferee who has acquired the lost property by way of auction or from a qualified seller is only obliged to return the property upon reimbursement of the expenses he has paid for the property.

Unlike its predecessor provision in the drafting process,⁹⁷ art. 107 does not explicitly refer to stolen property in addition to lost property. This is because the legislator believed that a remedy for retrieval of stolen property is primarily provided by criminal law, so the RRL could remain silent in this respect.⁹⁸ However, the rules contained in art. 107 RRL, which protect the original owner, should not only apply to lost property but even more to stolen property, so the original owner of stolen property should have the same right to reclaim the property from a *bona fide* transferee as the original owner of lost property.⁹⁹

⁹⁶ Pursuant to art. 107 cl. 2 RRL, the two-year period runs from the point in time where the original owner becomes, or ought to become, aware of the transferee. The provision does not set an absolute time limit. It seems, however, quite likely that the courts will apply the absolute time limit of 20 years provided for by art. 137 cl. 2 GPCL by way of analogy. (Art. 137 clause 2 GPCL reads: “However, the people’s court shall not protect his rights if 20 years have passed since the infringement.” For claims under art. 107 RRL, “infringement” would have to be read as “loss”.)

⁹⁷ *LIU Baoyu*, 25 (right column).

⁹⁸ *CHENG Xiao* (2010b), 533 note 41.

⁹⁹ cf. *CHENG Xiao* (2010b), 533.

6. Legal Tender

59 The RRL does not contain specific provisions with respect to legal tender, i.e. coins and banknotes currently used as a statutory means of payment (as opposed to collector's items such as coins or banknotes of historical currencies). It has been suggested to insert a provision to the effect that money is always owned by the person who possesses it.¹⁰⁰ At least, legal tender should have been exempt from art. 107 RRL in order to enhance the reliability of cash payments.

7. Real Security Rights

60 As already mentioned in the context of the requirement of payment of a reasonable price, not only ownership, but also real security rights can be acquired in good faith.¹⁰¹ Reversely, encumbered movable property can be acquired free from encumbrances if the third party acquiring the property in good faith was neither aware nor ought to have been aware of the encumbrance at the time of acquisition of ownership.¹⁰²

III. Other Ways of Acquisition and Loss of Ownership

1. Fruits

61 Property may bear fruits in a natural sense, e.g. apples from a tree, or in a legal sense (by virtue of a legal relationship), e.g. rent payments under a lease contract for a flat. Art. 116 RRL deals with the question of who is the owner of such fruits: Natural fruits go to the usufructuary or, in the absence of a usufructuary right over the property, to the owner. The question of ownership of natural fruits arises only after such fruits have been separated from the main thing. Until separation, natural fruits remain part of the main thing and cannot be subject to separate ownership. (However, there is no clarification to this effect in the Law.) Ownership of statutory fruits is obtained in accordance with the relevant agreement, if any; otherwise, customary practice prevails.

62

¹⁰⁰ *Liu Baoyu*, 26 (left column).

¹⁰¹ Cf. art. 106 para. 3 RRL; for details see *Tu Changfeng*, 198-200.

¹⁰² Art. 108 RRL.

Art. 116 RRL leaves a number of questions unanswered. (1) There is no provision with respect to fruits of things under joint ownership. From a logical point of view, the same form of joint ownership that applies to the main thing should also apply to the fruits. (2) When the main thing is encumbered, the fruits should in principle inherit such encumbrance. However, as encumbrances are beyond the control of a usufructuary, an exception has to apply for natural fruits that are acquired by a usufructuary. The usufructuary should be able to acquire the fruits free from encumbrances. (3) The protection of a *bona fide* possessor should also cover the fruits of the thing possessed in good faith, i.e. the *bona fide* possessor should become the owner of the fruits.

2. Trove

The finder of lost property is obliged to return it to the entitled person; for this **63** purpose, he has to notify the entitled person in a timely manner or deliver the property to the public security organs or other relevant department.¹⁰³ If the property is not claimed within six months after the notice of the finding is published, it will become the property of the state.¹⁰⁴ These rules also apply to flotsam and buried or hidden things unless other (more specific) laws stipulate otherwise.¹⁰⁵ The RRL does not provide for a finder's reward (e.g. a certain percentage of the property's value like in many other jurisdictions, as had been proposed in drafts of the RRL), but rather follows the moral rule of "not pocketing the money one picks up".¹⁰⁶

3. Succession

Real rights can be obtained by way of inheritance or acceptance of legacy.¹⁰⁷ **64** Pursuant to art. 29 RRL, the transfer of title takes place at the time of inheritance or acceptance of legacy, i.e. no registration is required for such a transfer. The regular registration requirements do apply, however, to the subsequent transfer of title by the successor or legatee to a third party (cf. art. 31 RRL).

¹⁰³ Art. 109 RRL.

¹⁰⁴ Art. 113 RRL.

¹⁰⁵ Art. 114 RRL.

¹⁰⁶ *Liu Baoyu*, 25 (right column).

¹⁰⁷ Cf. arts. 16 *et seqq.* of the Succession Law (继承法, promulgated on 10th April, 1985 and effective from 1st October, 1985).

4. Expropriation; Transfer by Court Decision

- 65** If the creation, modification, transfer or lapse of a real right is caused by an (enforceable) legal document of a people's court or of an arbitration committee or by a resolution on expropriation¹⁰⁸ issued by a people's government, the real right is created, modified, transferred, or lapses at the time when the respective document or resolution comes into effect (art. 28 RRL). This means that just as in the case of inheritance or acceptance of legacy (*supra* at 64), the regular registration requirements, if any, only apply to a subsequent transfer of title to a third party (art. 31 RRL).
- 66** The fundamental provision on the expropriation of immovable property is contained in art. 10 para. 3 of the Constitution. It provides for the possibility of expropriations "in public interest and in accordance with the law", as well as (since the 2004 amendment to the Constitution) for compensatory payments. Art. 42 RRL adds some detail with regard to compensation in case of expropriation of land owned by the collectives and of the houses and other immovables of units (i.e. legal entities) and individuals.¹⁰⁹ However, art. 42 does not set forth specific criteria for determining whether or not expropriation is "in the public interest" in an individual case. The legislator believed that there can be no universal definition of "public interest" and that the regional differences within China could better be dealt with under specific laws such as the Land Administration Law and the Urban Real Estate Administration Law¹¹⁰ (although said laws do not define the concept of "public interest" as well).

5. Concepts not Covered by the Law

- 67** The RRL does not address a number of concepts that (at least from a German law perspective) one would expect to be covered by the RRL. Among these are acquisitive prescription (时效取得¹¹¹) (i.e. acquisition of ownership by continuous

¹⁰⁸ Cf. art. 8 of the Regulation on the Expropriation of Buildings on State-owned Land and Compensation.

¹⁰⁹ In addition, see the Measures on the Assessment of Buildings on State-owned Land in Case of Expropriation.

¹¹⁰ *LIU Baoyu*, 23 (left column).

¹¹¹ Cf. *ZHANG Yuxin* (2010a), 120 (right column) and *LIU Baoyu*, 24 (left column).

possession over a specified period of time),¹¹² acquisition of ownership of things that are separated from other things, commingling, combination and production of new goods, and the loss of ownership by way of abandonment. It is conceivable that these gaps will be filled by judicial interpretations by the SPC or, in the case of adverse possession, by the general provisions of a future Chinese civil code¹¹³.

¹¹² Also see *supra* Chapter 3 at 6.

¹¹³ *Liu Baoyu*, 24 (left column). To date there is no general system of adverse possession in Chinese law (Sui Pengsheng, note 12); in particular, it is not covered by the GPCL (*TANG Dehua/GAO Shengping*, 3140).

Chapter 15. Condominium Property

Literature: *CHEN Huabin* (陈华彬), Condominium Ownership in Buildings: The Position of the Scholars' Draft and the Provisions of the "Real Rights Law" (建筑物区分所有权: 学者草案的立场与《物权法》的规定), *Journal of Gansu Institute of Political Science and Law* (甘肃政法学院学报) 2011, No. 2, 39-48, cited as *CHEN Huabin* (2011a). *CHEN Huabin* (陈华彬), Detailed Exploration of the Legal Institution of the General Meeting of the Proprietors (业主大会法律制度探微), *Legal Science* (法学) 2011, No. 3, 67-74, cited as *CHEN Huabin* (2011b). *CHEN Huabin* (陈华彬), On the Composition of Condominium Ownership in Buildings (论建筑物区分所有权的构成), *Tsinghua Law Review* (清华法学) 2008, No. 2, 99-113, cited as *CHEN Huabin* (2008). *CHEN Huabin* (陈华彬), On the Divestment of Condominium Ownership (论建筑物区分所有权的剥夺), *Studies in Law and Business* (法商研究) 2011, No. 6, 140-147, cited as *CHEN Huabin* (2011c). *CHEN Huabin* (陈华彬), On the Management Regulations of Condominium Buildings (论区分所有建筑物的管理规约), *Modern Law Science* (现代法学) 2011, No. 4, 49-58, cited as *CHEN Huabin* (2011d). *VAN DER MERWE, Cornelius G.*, A Comparative Assessment of the Provisions of the New Chinese Property Code on Condominiums, in: *CHEN Leil/VAN RHEE, Cornelis Hendrik (Remco)* (ed.), *Towards a Chinese Civil Code*, Leiden 2012, 177-207. *PISSLER, Knut Benjamin*, *Condominium in China (Wohnungseigentum in China)*, Tübingen 2013. *YANG Lixin* (杨立新), Fifteen Important Questions Governed by Three Judicial Interpretations on Real Rights Law (三部有关物权法司法解释规定的十五个重要问题), *Hebei Law Science* (河北法学) 2010, No. 5, 12-22.

I. Overview

- 1 Condominium ownership in buildings combines sole ownership of certain parts of a building (typically an apartment) and joint ownership of the common parts of the building (such as the hallway), along with the right to manage the common parts together with the other joint owners.¹ These three elements of condominium ownership are inextricably linked with each other and can only be transferred together.² Once ownership of an apartment is transferred, the acquirer automatically also becomes a joint owner of the common parts of the building and acquires the joint management right with respect to the common parts of the building.³
- 2 Condominium ownership is primarily governed by arts. 70-83 RRL. This comparably detailed set of provisions is complemented by the Interpretation of the SPC on Several Issues Concerning the Specific Application of Law in the Trial of Disputes

¹ Cf. art. 70 RRL.

² This is a German law concept developed by Johannes BÄRMANN; cf. *PISSLER*, 4.

³ Art. 72 para. 2 RRL.

over Condominium Ownership in Buildings (hereinafter: SPC Condominium Interpretation).⁴ Nevertheless, it is being argued that in the near future an even more comprehensive, self-contained law on condominium building ownership should be enacted.⁵

II. Combination of Sole and Joint Ownership

The RRL addresses the holder of condominium ownership as the “proprietor” (业主).³ The SPC Condominium Interpretation clarifies that this term does not only apply to the legal owner of a specified exclusive part of a building. Rather, a person who has not yet been registered as the owner but has legally acquired possession of the exclusive part of a building based on a contract with the construction entity for the sale of commodity premises (cf. *infra* Chapter 17 at 1-4) may also (but does not have to) be determined as a proprietor.⁶ Furthermore, the provisions on condominium property are also to be consulted (参照) when handling disputes involving users such as a lessee.⁷

Any specific space, such as a premise (which may be a whole building), parking space, or a booth, can be subject to sole ownership as a part of condominium property if it (1) has an independent structure and is clearly distinguishable, (2) can be used independently and exclusively, and (3) can be registered under the name of a specific proprietor.⁸ Space, such as a terrace, will form part of the exclusive premise under sole ownership if it has been planned as an exclusive part of a specific premise, and has been listed by the construction entity in the purchase contract of the premise.⁹ The proprietor’s right to possess, use, dispose of, and obtain profits from his exclusive premise¹⁰ is limited in that the exercise of these

⁴ For a more comprehensive collection (including German translations) of provisions concerning condominium property and related issues see *PISSLER*, 183-213.

⁵ *CHEN Huabin* (2011a), 45, 48.

⁶ Art. 1 para. 2 SPC Condominium Interpretation.

⁷ Art. 16 para. 1 SPC Condominium Interpretation.

⁸ Art. 2 paras. 1 and 3 SPC Condominium Interpretation. – In the author’s view, the third point mentioned above is the *result* of the fact that a certain space can be subject to sole ownership rather than a prerequisite.

⁹ Art. 2 para. 2 SPC Condominium Interpretation.

¹⁰ Art. 71 cl. 1 RRL (which basically replicates art. 39 RRL).

rights may not endanger the safety of the building or infringe on the lawful rights and interests of other proprietors.¹¹

5 Common parts, i.e. the parts under joint ownership, comprise any part that is neither an exclusive part nor a part owned by the municipality or by a third party, particularly (1) structural parts of the building such as the foundation, load-bearing structures, external walls, and roof; (2) passageways, staircases, lobbies, and other parts for public passage; and (3) firefighting, lighting, and other auxiliary parts.¹² The question arises whether joint ownership in the context of condominium property qualifies as co-ownership by shares or as common ownership. It is a distinctive feature of co-ownership by shares that a co-owner is free to transfer his share in the property (art. 101 RRL, cf. *supra* Chapter 13 at 19). Given that a proprietor is free to transfer ownership of his exclusive premise, which by operation of law causes the transfer of his joint ownership of the common parts of the building,¹³ such joint ownership resembles co-ownership by shares rather than common ownership. However, this classification is of a merely theoretical nature because the detailed provisions contained in arts. 70-83 RRL (as complemented by the SPC Condominium Interpretation) leave practically no room for the application of arts. 93 *et seqq.* RRL as general provisions. In particular, art. 101 clause 2 RRL (other co-owners' right of preemption under equal conditions) does not apply as it is superseded by art. 71 cl. 1 and art. 72 para. 2 RRL, which are *leges speciales*. Therefore, joint ownership in the context of condominium property should rather be seen as a joint ownership *sui generis*.

6 Another question is how to delineate an exclusive part from the rest of the building. There are two relevant theories, namely the “middle of the wall” theory (壁心说), according to which sole ownership ends in the middle of any boundary part of the building such as walls, pillars, floor and ceiling, and the “last layer of whitewash” theory (最后粉刷表皮说), which assigns only the last layer of whitewash to the respective exclusive part, as a result of which the boundary parts of the building are jointly owned. The prevailing view in Chinese literature advocates a combination of these two approaches: As far as the internal relationship among the proprietors is

¹¹ Art. 71 cl. 2 RRL.

¹² Art. 73 RRL and art. 3 SPC Condominium Interpretation.

¹³ Art. 71 cl. 1, art. 72 para. 2 RRL.

concerned, particularly with respect to maintenance works, the “last layer of whitewash” theory applies, whereas the “middle of the wall” theory has to be employed in external relations, e.g. to insurers or tax authorities.¹⁴

Although external walls and roofs are under joint ownership, it will not constitute a 7 violation of rights if a proprietor uses the part of the external wall or roof that corresponds to his exclusive part of the building, provided that such use is made in order to meet the reasonable demands of the utilization of his exclusive part of the building.¹⁵ Such reasonable demands include the use of the roof for the installation of antennas in case of residential use and the use of the outside walls for advertising purposes in case of commercial use.¹⁶

The RRL does not contain provisions on the divestment of a proprietor who fails to 8 fulfill his obligations or who infringes on the other proprietors’ rights. Some authors, however, are of the opinion that a mechanism to this effect could be implemented in the RRL or in a future law on condominium building ownership.¹⁷ It is indeed argued that, in case of severe infringements, even under the current RRL, the proprietors have the right to exclude a non-compliant co-proprietor.¹⁸

III. General Meeting of the Proprietors/Proprietors’ Committee

In order to exercise their right to jointly manage the common parts, the proprietors 9 may form a general meeting of the proprietors and elect a proprietors’ committee.¹⁹ Neither the RRL nor the Regulations on Realty Management or the Interpretation of the Supreme People’s Court on the Relevant Issues concerning the Application of Law for Trying Cases on Disputes over Contract for the Sale of Commodity Premises explicitly address the question whether the general meeting of the proprietors is a legal person.²⁰ Given that it is capable of enjoying rights and

¹⁴ CHEN Huabin (2008), 111/112; YANG Lixin, 13.

¹⁵ Art. 4 SPC Condominium Interpretation.

¹⁶ VAN DER MERWE, 185.

¹⁷ CHEN Huabin (2011c), 146, referring to the examples of German and Japanese law; VAN DER MERWE, 204, referring to the examples of German, Austrian and Swiss law.

¹⁸ SUN Yanping (孙延平), in: XI Xiaoming (奚晓明) (ed.), Understanding and Applying the Supreme People’s Court’s Judicial Interpretations on Condominium Ownership in Buildings and on Realty Services (最高人民法院建筑物区分所有权、物业服务司法解释理解与适用), Beijing 2009, 203 (as cited by PISSLER, 28 note 162, 29 note 164).

¹⁹ Arts. 70, 75 RRL; also see arts. 6-20 of the Regulations on Realty Management.

²⁰ CHEN Huabin (2011b), 68.

assuming liabilities under its own name, e.g. by opening a bank account,²¹ it can be said that the general meeting of the proprietors has legal capacity.

- 10** Resolutions on major matters must be adopted by the proprietors whose ownership of exclusive parts within the building in question accounts for at least two-thirds of the total construction area of the building and who accounts for no less than two-thirds of the total number of proprietors. Such major matters include the raising and use of funds for the maintenance of the building and any attached facilities, the renovation and reconstruction of the same, a change in the use of common parts, the use of common parts for business activities, and the disposal of common parts.²² Resolutions on all other matters require the consent of the proprietors whose ownership of the exclusive parts in the building accounts for more than half of the total construction area of the building and who account for more than half of the total number of proprietors.²³
- 11** The resolutions of the general meeting of the proprietors or the proprietors' committee are binding upon proprietors.²⁴ If a resolution infringes on a proprietor's lawful rights and interests, he may request a people's court to rescind the resolution.²⁵ However, he may only do so within one year's time after he has or should have become aware of the infringing resolution.²⁶ Moreover, each proprietor is entitled to demand disclosure of information on such matters as the raising and use of funds for the maintenance of the building and any attached facilities, contracts for realty management, or the use of common parts of the building, etc.²⁷

IV. Exclusive Rights to Use Common Parts

- 12** Neither the RRL nor any other source of law addresses exclusive rights to use common parts of buildings under condominium ownership.²⁸ In the light of the *numerus clausus* of real rights (*supra* Chapter 13 at 34), it is therefore questionable

²¹ CHEN Huabin (2011b), 68.

²² Art. 76 cl. 1 nos. 5-7 and cl. 2 RRL; art. 7 SPC Condominium Interpretation.

²³ Art. 76 cl. 1 nos. 1-4 and cl. 3 RRL.

²⁴ Art. 78 para. 1 RRL.

²⁵ Art. 78 para. 2 RRL.

²⁶ Art. 12 SPC Condominium Interpretation.

²⁷ Art. 13 SPC Condominium Interpretation.

²⁸ PISSLER, 5.

whether such exclusive rights can be established at all.²⁹ It is, however, common practice that rights to the use of parts under joint ownership are granted to one of the proprietors or to a third party, e.g. the right to put up a penthouse on the top of the building or to use a part of the surrounding site as a parking space^{30,31} Such an exclusive right can be established by the management statute (for details see below).³²

V. Management Statutes

Apart from the use of the property (including the rights and obligations of the 13 proprietors etc.), management statutes (管理规约) in practice also cover the selection of a realty management services provider, and set out rules on the settlement of disputes among the proprietors.³³ While the RRL does not set out a general requirement to establish a management statute, realty development enterprises have to establish (preliminary) management statutes before they sell the property (art. 22 para. 1 of the Regulations on Realty Management). Such management statutes tend to be in favor of the developer rather than of the (prospective) proprietors,³⁴ e.g. in that they grant the developer an exclusive right to use certain parts of the property. While art. 22 para. 2 Regulations on Realty Management states that preliminary management statutes may not infringe upon the prospective proprietors' lawful rights and interests, neither the RRL nor the Regulations on Realty Management address the question of the (in-)validity of such management statutes.³⁵ At any rate, to the extent the (preliminary) management statutes are legally effective, they can be changed by a resolution of more than half of the proprietors whose ownership of the exclusive parts in the building accounts for more than half of the total construction area of the building (art. 76 clause 1 no. 2 RRL).

²⁹ PISSLER, 6.

³⁰ Generally speaking, parking space cannot only form part of the common property, but can also be a standalone exclusive part of the building or an accessory to an exclusive part of the property such as an apartment or a commercial unit, cf. the in-depth analysis of the legal issues with respect to parking space by VAN DER MERWE, 185-195.

³¹ CHEN Huabin (2011a), 45.

³² CHEN Huabin (2011a), 45.

³³ CHEN Huabin (2011d), 54 (left column).

³⁴ CHEN Huabin (2011d), 55 (left column).

³⁵ CHEN Huabin (2011d), 57 (left column).

VI. Realty Management

- 14** Realty management is regulated by the RRL (arts. 81-83), the Regulations on Realty Management (particularly arts. 32-49), the Interpretation of the SPC on Several Issues Concerning the Specific Application of Law in the Trial of Disputes over Realty Services (hereinafter: SPC Realty Services Interpretation) and by local provisions such as the Measures of the City of Beijing on Realty Management. The proprietors may manage the building and its affixtures by themselves or entrust the matter to a realty service enterprise.
- 15** A realty services contract will be binding upon all the proprietors not only if it has been entered into by the general meeting of the proprietors or the proprietors' committee, but also if the contract has been made by the construction entity before the completion of the building.³⁶ In the absence of an explicit agreement, the share of the costs of the realty management a proprietor has to bear will be determined on the basis of the ratio of the area of the exclusive parts held by the proprietor to the total construction area of the building.³⁷
- 16** In order to protect the proprietors from disadvantageous realty services contracts, clauses in such contracts that exempt the liability of the realty service enterprise, that increase the liability of the proprietors' committee or proprietors, or that exclude their principal rights, are void.³⁸ In addition, the proprietors have the right to replace a realty services enterprise that was employed by the construction entity.³⁹ Not only has the realty service enterprise to perform the repair, maintenance, management and protection services stipulated in the realty service contract, the relevant laws and regulations or the relevant industrial norms. Rather, any service commitments publicly made by the realty service enterprise are also deemed to form part of the realty service contract.⁴⁰ A realty services contract can be unilaterally terminated by the general meeting of the proprietors, but not the proprietors' committee⁴¹, by way of a decision in accordance with art. 76 clause 1 no. 4 RRL.⁴²

³⁶ Art. 1 SPC Realty Services Interpretation.

³⁷ Cf. art. 80 RRL.

³⁸ Art. 2 para. 1 no. 2 SPC Realty Services Interpretation.

³⁹ Art. 81 para. 2 RRL.

⁴⁰ Art. 3 SPC Realty Services Interpretation.

⁴¹ YANG Lixin, 17.

⁴² Art. 8 para. 1 SPC Realty Services Interpretation.

Chapter 16. Usufructuary Rights

Literature: *Bu Yuanshi* (卜元石), Introduction to Chinese Law (Einführung in das Recht Chinas), Munich 2009. *Liu Baoyu* (刘保玉), The Achievements and Shortcomings of China's Real Rights Law (中国物权法的成就与不足), Legal Forum (法学论坛) 2008, No. 5, 21-28. *MÜNZEL*, Real Rights Law (Sachenrechtgesetz), China's Law (Chinas Recht), 16.3.07/1. *WESIACK*, The System of Land-use rights in Chinese Real Estate Law, Journal on Chinese Law (Zeitschrift für Chinesisches Recht) 2005, No. 3, 177-195.

I. Overview

There is no private ownership of land under Chinese Law. Land in the cities is 1 owned by the state, and land in rural and suburban areas is owned by collectives except for portions belonging to the state as prescribed by law.¹ However, the Constitution mentions land use rights that can be transferred in accordance with the laws.² These land use rights act as a substitute for private ownership of land.

The right to possess, use and benefit from a thing³ is referred to as a usufructuary 2 right under the RRL. Pursuant to the general provisions on usufructuary rights contained in the RRL, such rights can relate to either movable or immovable property.⁴ However, all the four types of usufructuary rights explicitly addressed by the RRL (which will be discussed in more detail below) are usufructuary rights over immovable property. As usufructuary rights (except for the easement on land) serve as substitutes for private ownership of land, the pivotal questions are how long they last, whether they can be extended or prematurely cancelled, and whether a usufructuary can transfer his rights.

The RRL does not consolidate all the provisions on usufructuary rights over 3 immovable property. Some of them, e.g. the collectives' right to use reserve land previously retained by them,⁵ are not covered at all; others, such as the right of members of rural economic collectives to farm plots of cropland and hilly land

¹ Art. 10 paras. 1 and 2 of the Constitution; also see *supra* Chapter 13 at 27.

² Art. 10 para. 4 cl. 2 of the Constitution.

³ The only power that remains with an owner who has granted a usufructuary right is therefore the right of disposal (for the owner's powers in general cf. *supra* Chapter 13 at 9).

⁴ Cf. art. 117 RRL.

⁵ The collectives' right to use reserve land (机动地) is governed by arts. 28 no. 1 and 63 of the Law on Land Contract in Rural Areas (农村土地承包法), promulgated on 29th August, 2002 and effective from 1st March, 2003; last revision effective from 27th August, 2009). – In addition, *Liu Baoyu*, 26 (left column) mentions the right of dwelling (居住权).

allotted for their private use⁶ and the right enjoyed by a town (township) or village enterprise to the use of land for construction⁷, are mentioned only very briefly.⁸

II. Right to the Use of Land for Construction

- 4 The holder of a right to the use of land for construction (建设用地使用权) is entitled to possess, use, and benefit from the land, as well as to erect buildings on the land.⁹ A right to the use of land for construction can refer to either state-owned (i.e. urban) land or land owned by a collective (i.e. rural land).¹⁰ There is a rebuttable presumption that the holder of the right to the use of land for construction is the owner of any buildings he has erected while exercising his rights.¹¹ This means that ownership of the land (which remains with the state or the respective collective) and ownership of the building thereon are separated from each other unless the building is owned by the state or the respective collective.
- 5 Instead, there are several provisions to the effect that the ownership of buildings and the land use right (not the ownership of the land) are always held by the same person or entity (“land follows building, building follows land”, 地随房走, 房随地走¹²). In particular, any disposal of the land use right also includes the buildings and vice versa.¹³ At first glance, the relevant provisions seem to provide that land and buildings are transferred along with each other by operation of law, i.e. without the need to separately transfer the land use right when the building has already been transferred. However, there is case law with respect to the pre-RRL provisions indicating that a party who has transferred a building is only under an obligation to

⁶ Cf. art. 8 para. 1 cl. 3 of the Constitution and art. 184 no. 2 RRL.

⁷ Art. 183 RRL.

⁸ MÜNZEL, note 1.

⁹ Art. 135 RRL.

¹⁰ As can be seen from arts. 151 and 183 RRL, the Law presupposes that there can be a right to the use of land for construction not only with respect to state-owned land but also with respect to collectively owned land. Some authors (cf. BU YUANSI, 145 note 122) argue that this could be doubted in light of the *numerus clausus* of real rights because the RRL does not directly prescribe the latter type of right to the use of land for construction. However, the *numerus clausus* (cf. *supra* Chapter 13 at 34) only means that every type of real right has to be prescribed by law, but not necessarily by the RRL. Arts. 43 para. 1 and 60 Land Administration Law explicitly addresses the right to the use of collectively owned land for construction.

¹¹ Art. 142 RRL.

¹² Cf. the SPC's judgement referred to in note 14 below.

¹³ Arts. 146 and 147 RRL; art. 32 Urban Real Estate Administration Law.

transfer the corresponding land use right as well.¹⁴ Given that the wording of the relevant RRL provisions differs only slightly from the pre-RRL provisions,¹⁵ it is unlikely that the RRL has changed the situation.

A land use right with respect to state-owned land can be created by way of 6
assignment (granted land use right 出让土地使用权) or allocation (allocated land use
right 划拨土地使用权).¹⁶ While granted land use rights have to be paid for,¹⁷
allocated land use rights can basically¹⁸ be obtained free of charge. Where land is to
be used for business purposes (such as industrial, commercial, tourist, or
entertainment purposes, or for the construction of commodity premises), or there is
more than one interested party willing to use the same piece of land, the right to the
use of land for construction will be a granted land use right which is assigned
through bid invitation, auction, or another kind of open bidding.¹⁹

While allocated land use rights are not subject to a time limit,²⁰ the term of a granted 7
land use right is limited and its duration depends on the type of use of the land.
Pursuant to the Interim Regulations Concerning the Assignment and Transfer of the
Right to the Use of the State-owned Land in Urban Areas (hereinafter: Land Use
Right Regulations), the maximum term is 70 years for residential use, 50 years for
industrial use, as well as for the use for the purposes of education, science and
technology, culture, sanitation, or sports, and 40 years for commerce, tourism and
entertainment.²¹

¹⁴ *Xi'an Office of China Cinda Asset Management Corporation v Xi'an Transfer Cold Storage of Shaanxi Provincial Cereals, Oils & Foodstuffs Import & Export Corporation and Shaanxi Provincial Cereals, Oils & Foodstuffs Import & Export Corporation* in respect of a dispute over a loan guarantee contract (中国信达资产管理公司西安办事处与西安中转冷库、陕西省粮油食品进出口公司借款担保合同纠纷案), judgement of the SPC dated 30th December, 2008.

¹⁵ Under art. 32 Urban Real Estate Administration Law, the land use right and the building are transferred "at the same time (同时)", whereas under arts. 146 and 147 RRL, they are disposed of "along with each other" (一并).

¹⁶ Art. 137 para. 1 RRL; arts. 8 and 23 Urban Real Estate Administration Law; art. 54 Land Administration Law.

¹⁷ Art. 8 Urban Real Estate Administration Law; art. 55 Land Administration Law.

¹⁸ Except for the land use tax, cf. art. 43 para. 2 of the Interim Regulations Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in Urban Areas. In addition, the new user may be required to pay compensation and expenses for resettlement to the members of the rural collective who previously used the land (art. 23 para. 1 Urban Real Estate Administration Law).

¹⁹ Art. 137 para. 2 RRL.

²⁰ Art. 23 para. 2 Urban Real Estate Administration Law.

²¹ Art. 12 Land Use Right Regulations.

- 8 A granted land use right lapses upon expiry of its term without any compensation being paid to the holder of the land use right,²² and the state acquires ownership of any buildings erected on the land.²³ In special circumstances, the state has the right to cancel a granted land use right prior to the expiration of its term for the public benefit in return for compensation.²⁴ If the holder of a land use right having a residual term of at least one year applies for an extension of its term, the extension will have to be granted, unless public interest requires otherwise, in return for payment of a utilization fee.²⁵ Pursuant to art. 149 para. 1 RRL, land use rights for the construction of residential buildings are automatically extended. However, the provision does not clarify whether a new utilization fee has to be paid for the extension, leaving this question to future laws or regulations.²⁶
- 9 Granted rights to the use of state-owned land for construction can be freely transferred.²⁷ The transferability of granted rights regarding the use of collectively owned land for construction, on the other hand, is very limited. Such land use rights can devolve upon a third party only as a result of the original holder going bankrupt or being merged.²⁸ Unlike granted land use rights, allocated land use rights cannot be disposed of unless they are converted into granted land use rights beforehand.²⁹

III. (Rural) Land Contracted Management Right

- 10 A contractor for the right to land management (土地承包经营权) has the right to possess, use, and benefit from the cultivated land, forestlands, grasslands etc. which are under his contractual management, and is entitled to engage in agricultural production, including crop cultivation, forestry, and animal husbandry.³⁰ The right to land management comes into existence as of the effective date of the respective contract and its term is 30 years for arable land, 30 to 50 years for grassland and 30 to 70 years for forestland.³¹ Unlike in the first draft of the RRL,³²

²² Art. 22 para. 2 Urban Real Estate Administration Law.

²³ Art. 40 Land Use Right Regulations.

²⁴ Art. 42 Land Use Right Regulations.

²⁵ Art. 22 para. 1 Urban Real Estate Administration Law; art. 41 Land Use Right Regulations.

²⁶ *Liu Baoyu*, 24 (right column).

²⁷ Art. 143 RRL.

²⁸ Art. 63 Land Administration Law.

²⁹ Arts. 44, 45 Land Use Right Regulations. For details see *WESIACK*, 180.

³⁰ Art. 125 RRL.

³¹ Arts. 20, 22 Contracting of Rural Land Law and arts. 126 para. 1, 127 para. 1 RRL.

there is no equivalent to art. 149 para. 1 RRL, so the term of land management rights is not automatically extended.³³

A contractor for the right to land management is entitled to circulate the right to land contractual management by subcontracting, leasing, exchanging, or transferring the right, whereas under equal conditions members of the respective collective enjoy a right of priority.³⁴ Such circulation does not require registration in order to become effective, but exchange and transfer need to be registered in order to be opposable against a *bona fide* third party.³⁵ While the right to land management remains unaffected if during the term of contract, the whole contracting household moves into a small town and settles down there, the right must be given up if the contracting household's rural residence registration is changed to non-rural residence registration following a relocation to a city divided into districts.³⁶ 11

IV. Right to the Use of (Rural) Residential Housing Land

The holder of a right to the use of residential housing land (宅基地) is entitled to possess and use collectively-owned (i.e. rural) land and to build a residential house and any accessory facilities on such land.³⁷ Pursuant to art. 153 RRL, the acquisition, exercise, and transfer of rights to the use of residential housing land is subject to the Land Administration Law "as well as other laws and the relevant regulations of the state". The Land Administration Law addresses rights to the use of residential housing land primarily in its art. 62, taking a rather restrictive approach towards these rights. 12

Art. 62 para. 4 Land Administration Law suggests that rights to the use of residential housing land can be circulated among the members of the respective collective.³⁸ It is, however, unclear whether rights to the use of residential housing land can also 13

³² MÜNZEL, note 11.

³³ Art. 126 para. 2 RRL only states that the contract may be renewed "in accordance with the relevant regulations of the state".

³⁴ Art. 128 RRL, arts. 32, 33 no. 5 Contracting of Rural Land Law.

³⁵ Art. 129 Real Rights Law; cf. *supra* Chapter 14 note 34. Liu Baoyu, 25-26 points out that it appears inconsistent that a charge over a land contracted management right needs to be registered in order to become effective (arts. 180 para. 1 no. 3, 187 cl. 2 RRL) given that its legal consequences are less severe than those of the transfer of a land contracted management right.

³⁶ Art. 26 paras. 3 and 3 Contracting of Rural Land Law.

³⁷ Art. 152 RRL.

³⁸ *Bu Yuanshi*, 146 note 130. Art. 62 para. 4 Land Administration Law reads: „Reapplication for residential housing land by a villager in a rural area who has sold or rented out his house shall not be approved.“

be transferred to urban residents. In practice, urban residents do buy or build residential houses on land owned by collectives, but their legal title to such houses is generally referred to as “small property” (小产权) due to the large amount of legal uncertainty involved.³⁹ An official document of November 2011 explicitly refers to “small property houses” as illegal use of land,⁴⁰ which makes it seem very unlikely that “small property” will be accepted by the courts.

V. Easement on Land

- 14** An easement (地役权) holder has the right to use⁴¹ another person’s immovable property (the servient estate) to obtain better results from his immovable property (the dominant estate).⁴² In other words, an easement contract modifies the scope of the right to use the two concerned pieces of immovable property in that it extends the right to use the dominant estate and inversely narrows down the right to use the servient estate.⁴³ Therefore, only a party who has the right to use the servient estate may create an easement over it. The right to use immovable property is either held by its owner (which in the case of land can only be the state or a collective, cf. *supra* at 1) or by the holder of a land use right (*supra* at 4-13). When a land use right has already been established, the state or the collective owning the land may not create an easement without the consent of the holder of such land use right.⁴⁴ The term of an easement created by the holder of a land use right may not exceed the remaining duration of such land use right.⁴⁵
- 15** The type of use of the servient estate, e.g. a right of way, and the terms of such use are usually set out in the contract for easement.⁴⁶ An easement is created as of the time when the easement contract becomes valid, but the easement is not opposable

³⁹ For a detailed discussion see MÜNZEL, note 1.

⁴⁰ Some Opinions of the Ministry of Land Resources, the Office of the Central Rural Work Leading Group, the Ministry of Finance and the Ministry of Agriculture on the Registration and Issuance of Certificates of Ownership of Rural Collective Land (国土资源部、中央农村工作领导小组办公室、财政部、农业部关于农村集体土地确权登记发证的若干意见) issued on 2nd November, 2011 (section 10).

⁴¹ The wording of the Law (“use”, in Chinese: 利用) suggests that (unlike under art. 1018 of the German Civil Code (*Bürgerliches Gesetzbuch*)) an easement may not involve an obligation not to undertake particular acts on the servient estate.

⁴² Art. 156 RRL.

⁴³ Arts. 159, 160 RRL.

⁴⁴ Art. 163 RRL.

⁴⁵ Art. 161 RRL.

⁴⁶ Art. 157 RRL.

against a *bona fide* third party unless it has been registered.⁴⁷ The easement is not attached to the parties to the easement contract but rather to the rights to use the concerned pieces of immovable property that are modified by the easement. Therefore, when the right to land contractual management or the right to the use of land for construction is transferred, the easement is transferred along with it.⁴⁸

⁴⁷ Art. 158 RRL.

⁴⁸ Art. 164 cl. 2 RRL.

Chapter 17. Real Estate Purchase Agreement

Literature: *CHENG Xiao* (程啸), On the Differentiation Between Public Reliance on the Land Register and Bona Fide Acquisition of Movable Property (论不动产登记簿公信力与动产善意取得的区分), *Peking University Law Journal* (中外法学) 2010, No. 4, 524-539, cited as *CHENG Xiao* (2010b). *Li Yongjun* (李永军), Reflections on the First Part of the Real Rights Law (对《物权法》第一编的反思), *Contemporary Law Review* (当代法学) 2010, No. 2, 7-20.

I. Overview

- 1 Real estate purchase contracts are primarily governed by the general provisions on sales and purchase contracts (arts. 130-175 CL) and by the Urban Real Estate Administration Law (arts. 37-46). When a real estate development enterprise sells premises (which may either be completed or not yet built) to the society, special rules with respect to such “commodity premise purchase and sale contract” can be found in the Interpretation of the SPC on the Relevant Issues concerning the Application of Law for Trying Cases on Disputes over Contract for the Sale of Commodity Premises (hereinafter: SPC Commodity Premises Interpretation).

II. Validity and Contents of the Contract

- 2 Contracts on the transfer of urban real property must be made in writing and have to contain a clause stating in which way the land use right has been acquired,¹ and the seller has to report the purchase price to the department designated by the government at or above county level.² When commodity premises are to be pre-sold (i.e. premises are sold before they are completed), the seller has to obtain a commodity premises pre-sale license (商品房预售许可证明).³ If the seller has not obtained such a license, the contract on the pre-sale of commodity premises will be void unless the license is granted before legal action is taken.⁴

3

¹ Art. 41 Urban Real Estate Administration Law. Depending on the way in which the land use right has been acquired, the special requirements set out in arts. 39 and 40 Urban Real Estate Administration Law for granted and allocated land use rights respectively apply.

² Art. 35 Urban Real Estate Administration Law.

³ Art. 45 para. 1 no. 4 Urban Real Estate Administration Law.

⁴ Art. 2 of the SPC Commodity Premises Interpretation.

Statements in advertisements and publicity materials with respect to commodity premises are mere invitations to offer. Therefore, they are not automatically included in the terms of the purchase and sale contract. By contrast, specific explanations and undertakings made by a seller regarding premises and related facilities within the scope of a commodity premise development plan that have a material impact on the conclusion of the commodity premises purchase and sale contract and the price of the premises are deemed to be offers. Such explanations and undertakings will therefore be deemed as particulars of the contract for the sale of the commodity premises even if they are not explicitly included in the contract.⁵

III. Passing of Risk

As a general rule, the risk of damage or loss of the targeted matter is borne by the seller prior to delivery and by the buyer after delivery.⁶ In cases of commodity premises, the passing of risk (风险转移)⁷ takes place upon “delivery for use”,⁸ which will usually be the case when the buyer receives the keys to housing premises that are ready for use. If the buyer has received the seller’s written notice to accept delivery and still refuses to accept the premises without proper reason, the risk will pass to the buyer from the date of delivery for use stipulated in the written notice on.⁹

IV. Registration and Ownership Certificate

The buyer of real estate will usually have an interest to make certain that the seller actually has the power to dispose of the targeted matter. Therefore, he is entitled to inspect the register of the immovables,¹⁰ which is reported to be increasingly quick and convenient in practice.¹¹ Before the RRL came into effect, ownership

⁵ Art. 3 of the SPC Commodity Premises Interpretation.

⁶ Art. 142 CL.

⁷ Cf. *Li Yongjun*, 15.

⁸ Art. 11 para. 2 of the SPC Commodity Premises Interpretation.

⁹ Art. 11 para. 2 of the SPC Commodity Premises Interpretation.

¹⁰ Art. 18 RRL. Detailed rules are set out in the Measures on the Public Inspection of Land Registration Data (土地登记资料公开查询办法, issued by the Ministry of Land Resources on 4th December, 2002 and effective from 1st January, 2003) and the Interim Measures on the Inspection of House Ownership Register Information (房屋权属登记信息查询暂行办法, issued by the Ministry of Construction on 8th October, 2006 and effective from 1st January, 2007).

¹¹ *CHENG Xiao* (2010b), 539 note 63.

certificates¹² used to be more trusted than the registers because of the flaws of the system of registration.¹³ They are still relevant as a means of evidence, but in cases of inconsistencies with the register, the latter will prevail, unless it can be demonstrated that there are errors in what is recorded in the register.¹⁴

¹² Cf. arts. 17, 127 para. 2, 139 clause 2 RRL.

¹³ *CHENG Xiao* (2010b), 534.

¹⁴ Art. 17 RRL.

Relevant Laws & Regulations

<i>Title</i>	<i>Promulgation Date</i>	<i>Effective Date</i>	<i>Last Revision Effective from</i>
Constitution (宪法)	12/4/1982	12/4/1982	3/14/2004
General Principles of Civil Law (民法通则)	4/12/1986	1/1/1987	8/27/2009
Land Administration Law (土地管理法)	6/25/1986	1/1/1987	8/28/2004
Opinions of the Supreme People's Court on Several Issues concerning the Implementation of the General Principles of Civil Law of the People's Republic of China (For Trial Implementation) (最高人民法院关于贯彻执行《中华人民共和国民法通则》若干问题的意见(试行))	4/2/1988	4/2/1988	12/24/2008
Interim Regulations Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in Urban Areas (城镇国有土地使用权出让和转让暂行条例)	5/19/1990	5/19/1990	---
Urban Real Estate Administration Law (城市房地产管理法)	7/5/1994	1/1/1995	8/30/2007
Contract Law (合同法)	3/15/1999	10/1/1999	---
Contracting of Rural Land Law (农村土地承包法)	8/29/2002	3/1/2003	8/27/2009
Interpretation of the Supreme People's Court on the Relevant Issues concerning the Application of Law for Trying Cases on Dispute over Contract for the Sale of Commodity Premises (最高人民法院关于审理商品房买卖合同纠纷案件适用法律若干问题的解释)	4/28/2003	6/1/2003	---
Regulations on Realty Management (物业管理条例)	6/8/2003	9/1/2003	10/1/2007
Real Rights Law (物权法)	3/16/2007	10/1/2007	---
Measures for Building Registration (房屋登记办法)	2/15/2008	7/1/2008	---
Interpretation II of the Supreme People's Court of Several Issues concerning the Application of the Contract Law of the	4/24/2009	5/13/2009	---

People's Republic of China (最高人民法院
关于适用《中华人民共和国合同法》若干问
题的解释(二))

Interpretation of the Supreme People's Court on Several Issues Concerning the Specific Application of Law in the Trial of Disputes over Condominium Ownership in Buildings (最高人民法院关于审理建筑物区分所有权纠纷案件具体应用法律若干问题的解释)	5/14/2009	10/1/2009	---
Interpretation of the Supreme People's Court on Several Issues Concerning the Specific Application of Law in the Trial of Disputes over Realty Services (最高人民法院关于审理物业服务纠纷案件具体应用法律若干问题的解释)	5/15/2009	10/1/2009	---
Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law in the Trial of Cases about Disputes over Lease Contracts on Urban Buildings (最高人民法院关于审理城镇房屋租赁合同纠纷案件具体应用法律若干问题的解释)	7/30/2009	9/1/2009	---
Tort Liability Law (侵权责任法)	12/26/2009	7/1/2010	---
Measures of the City of Beijing on Realty Management (北京市物业管理办法)	4/20/2010	10/1/2010	--
Regulation on the Expropriation of Buildings on State-owned Land and Compensation (国有土地上房屋征收与补偿条例)	1/21/2011	1/21/2011	---
Measures on the Assessment of Buildings on State-owned Land in Case of Expropriation (国有土地上房屋征收评估办法)	6/3/2011	6/3/2011	---
Interpretation of the Supreme People's Court on Issues Concerning the Application of Law in the Trial of Cases about Disputes over Purchase and Sale Contracts (最高人民法院关于审理买卖合同纠纷案件适用法律问题的解释)	5/10/2012	7/1/2012	---

Part V Conflict of Laws

Chapter 18. Overview

Literature: *GUO Yujun* (郭玉军)/*CHE Ying* (车英), Summary of the 1998 Annual Conference of Chinese Society of Private International Law (中国国际私法学会 1998 年年会综述), Chinese Yearbook of Private International Law and Comparative Law (中国国际私法与比较法年刊), Beijing 1999. *HAN Depei* (韩德培), A New Issue in Research of China's Public International Law: on China's Interregional Law Issues (论我国区际法律冲突问题——我国国际私法研究中的一个新课题), Chinese Legal Science (中国法学) 1988, No. 6, 3-10. *HAN Depei* (ed.) (韩德培(编著)), New Theory of Private International Law (国际私法新论), Wuhan 1997. *HARTLEY*, International Litigation and Transaction from a Common Law Perspective (General Course on Private International Law, Hague Academy of International Law, 2006), Leiden/Boston 2007. *HE Qisheng* (何其生), Thirty Years of China's Scholarship on Private International Law: 1978-2008 (中国国际私法学三十年: 1978-2008), Wuhan University Review of International Law (武大国际法评论), 2009, No. 3, 251-275. *HUANG Jin* (黄进), Study on China's Interregional Law Issues (中国区际法律问题研究), Beijing 2001. *HUANG Jin* (黄进), The Making and Improving of the the Law of the Application of Law for Foreign-related Civil Relations (中国涉外民事关系法律适用法的制定与完善), Tribune of Political Science and Law (政法论坛) 2011, No. 29 (3), 3-12. *Huo Zhengxin* (霍政欣), Private International Law in China (中国国际私法(英文版)), Beijing 2010. *Liu Weixiang et al.* (刘卫翔等), Theory and Practice of Chinese Private International Law (中国国际私法理论与实践), Wuhan 1995. *QU Guangqing* (ed.) (屈广清(编著)), Introduction of Private International Law (国际私法导论), Beijing 2005. *TANG Biaoming* (唐表明), Comparative Private International Law (比较国际私法), Guangzhou 1987. *WAN E'xiang* (ed.) (万鄂湘编著), Understanding and Applying the Law of the Application of Law for Foreign-related Civil Relations (涉外民事关系法律适用法条文理解与适用), Beijing 2011. *Xu Weigong* (徐伟功), Institutional Change of China's New Private International Law (简论新中国国际私法的制度变迁), Oriental Forum (东方论坛) 2007, No. 2, 121-124. *Yu Fei* (于飞), Theory and Legislation of Chinese Private International Law (中国国际私法理论与立法), Beijing 2004.

I. Debate on the Scope of Private International Law

- 1 For the past decade, Chinese scholars have heatedly discussed the extent of private international law. Some scholars have proposed a narrow scope of coverage. According to these scholars, the coverage of private international law is limited to rules on jurisdiction, rules on application of law, including rules on choice of laws and on conflict of laws, and rules on recognition and enforcement of foreign

judgments.¹ This narrow understanding of the extent of private international law is roughly in line with scholars' understanding of private international law internationally.²

In contrast, other scholars advocate a broad scope of private international law coverage. According to these scholars, private international law is a combination of rules on conflict of laws, substantive rules, and procedural rules.³ It has five major components: rules on conflict of laws, uniform substantive rules governing civil and commercial relations, international customs, procedural rules on international civil litigation, and procedural rules on international commercial arbitration.⁴

Mainstream Chinese scholars appear to support the broad understanding. Prof. Han Depei, a prominent Chinese scholar of private international law, even proposed his famous “one plane, two wings theory” to explain the broad understanding of private international law:

“Private international law is like an airplane; the body of the plane is the contents and the wings are the extensions. If one were to apply such a theory to private international law, the contents not only include rules on conflict of laws, but they also cover uniform substantive law rules. They even include state laws that may be applied directly to foreign-related commercial relations. One wing would cover issues of nationality and the legal status of foreigners, which is also a precondition for dealing with foreign-related civil relations; the other wing would include the procedural rules that may be applied to international civil litigation and arbitration, including rules relating to jurisdiction, judicial assistance, recognition and enforcement of foreign judgments and arbitral awards.”⁵

Obviously, the two schools of thought are substantially different. The essential difference lies in whether uniform substantive law rules, such as the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG) and many other international civil and commercial legal instruments, should fall within

¹ TANG Biaoming, 15-23; QU Guangqing (ed.), 35; Yu Fei, 47.

² For instance, Prof. Hartley divides private international law into three parts, namely, jurisdiction, choice of law, and recognition and enforcement of foreign judgments. See generally HARTLEY.

³ GUO Yujun/CHE Ying, 501-502.

⁴ See, e.g. HAN Depei (ed.), 9-12.

⁵ LIU Weixiang et al., 40.

the scope of private international law or not. In this book, the narrow understanding of private international law has been adopted.

II. Historical Review of Private International Law

- 6 Some Chinese scholars tend to hold the opinion that private international law could date back to as early as the 7th century, when the Tang Dynasty reigned in ancient China. Such opinion is based largely on the fact that by that time, due to its prosperity and global influence, China had to enact laws to deal with foreign-related business relations and to grant civil status to foreigners.⁶ Obviously, the laws of the Tang Dynasty cannot be deemed as private international law in its modern and strict sense. The earliest code of modern private international law did not appear in China until 1918, when the Republic of China promulgated the “Act of Application of Law”, which was modeled largely after German and Japanese laws.⁷ It is even held by some Chinese scholars that this Act, composed of seven chapters and 27 articles, was one of the most “complicated and advanced” codes of private international law in the world of by this time.⁸
- 7 Since the founding of the People’s Republic of China (PRC) in 1949, however, the development of private international law had been delayed for many years. In general, since 1949, the development of Chinese private international law echoed the trend of China’s social and economic development, which can be divided into several periods.
- 8 The first period runs from the time when the PRC was established in 1949 to the time when China opened up in the late 1970s. As is well known, China was isolated by the international community and adopted a closed-door policy during this period. Such isolation not only heavily restricted foreign-related civil and commercial activities, but also seriously impeded the development of China’s legal system, including private international law.⁹
- 9 The second period runs from the late 1970s, when China adopted its “reform and opening-up policy”, to the end of the 20th century. Since 1979, many foreign

⁶ See, e.g. *Huo Zhengxin*, 49-50.

⁷ *Huo Zhengxin*, 50.

⁸ *Yu Fei*, 12.

⁹ *Xu Weigong*, 121-122.

companies began to invest in China and thus brought in foreign direct investments on a large scale as well as enhanced foreign-related communications. Naturally, this also brought about an urgent need for the promulgation of laws and rules that could be applied to foreigners and foreign-related issues. In order to meet such needs, China promulgated various laws and concluded or acceded to various international treaties, including those of private international law. These laws, thought to govern various different aspects of social life, formed the foundation and main body of private international law.¹⁰ Besides, at the international level, two highlighting achievements of this period are China's accession to the International Institute for the Unification of Private Laws (UNDROIT) in 1985 and the Hague Conference on Private International Law in 1987.

The rules of private international law are scattered in various legal instruments. **10** Although it is unnecessary and impossible to produce an exhaustive list of these rules, they can be roughly categorized into four different types:¹¹ (1) rules granting foreigners civil legal status within Chinese territory, e.g. certain provisions in the Constitution¹²; (2) rules on conflict of laws, e.g. certain provisions in the General Principles of Civil Law (GPCL)¹³ and in the Contract Law (CL)¹⁴; (3) rules dealing with international and foreign-related civil procedural issues, e.g. certain provisions in the Civil Procedural Law (CPL)¹⁵; and (4) rules dealing with international and foreign-related commercial arbitration, e.g. certain provisions in the Arbitration Law¹⁶ and the CPL.

The third period, which is still ongoing, started at the end of the 20th century, and is **11** highlighted by China's accession to the World Trade Organization (WTO) in late 2001. During this period, in light of the rapid economic globalization process and the on-going efforts to unify private law rules at the international level, China seriously considered changing the status quo of private international law. Following the suggestion of many scholars, the Chinese Society of Private International Law

¹⁰ A non-exhaustive list of such laws can be found in *WAN E'xiang*, 17-20.
¹¹ *Yu Fei*, 13-14.
¹² 宪法, promulgated on and effective from 4th December, 1982; last revision effective from 14th March, 2004.
¹³ 民法通则, promulgated on 12th April, 1986 and effective from 1st January, 1987.
¹⁴ 合同法, promulgated on 15th March, 1999 and effective from 1st October, 2007.
¹⁵ 民事诉讼法, promulgated on 9th April, 1991 and effective from 9th April, 1991; last revision effective from 28th October, 2009.
¹⁶ 仲裁法, promulgated on 31st August, 1994 and effective from 1st September, 1995.

formed a research group in 1993 and completed the draft Model Private International Law (Model PIL) in 2000, which later played an important role in China's development of its first private international law code.¹⁷ The adoption of China's first uniform and comprehensive code of private international law, namely, the Law of Application of Law for Foreign-Related Civil Relations (LAL)¹⁸ is considered to be a milestone achievement of this period. Yet, as this period is still ongoing, it remains to be seen how China will further develop its rules on private international law to meet future practical needs.

III. Framework of Private International Law Prior to the Promulgation of the LAL

- 12 As mentioned earlier (*supra* at 10), the rules on private international law, are scattered in many different national laws and regulations. Some laws contain a special chapter that deals exclusively with foreign-related issues, such as Chapter 8 of the GPCL, Chapter 4 of CPL, Chapter 14 of the Maritime Law¹⁹ and Chapter 5 of the Negotiable Instruments Law²⁰. Other laws contain only several provisions on conflict of laws, such as the Succession Law²¹ and the CL.²² It has been suggested that, in total, China has over 470 rules on private international law, which are scattered among more than 140 national laws, administrative regulations, and SPC judicial interpretations.²³
- 13 Among these laws, the GPCL is worth mentioning due to its fundamental role in China's legal system. Chapter 8 of the GPCL deals exclusively with issues of law in foreign-related civil relations. Chapter 8 of the Opinions of the SPC on Certain Issues concerning the Implementation of the General Principles of Civil Law of the PRC (Trial) (Opinions on the GPCL)²⁴ provides a series of rules on conflict of laws tailored for foreign-related civil issues. With these rules in place, it is generally

¹⁷ See generally *He Qisheng*, 264.

¹⁸ 涉外民事关系法律适用法, promulgated on 28th October, 2010 and effective from 1st April, 2011.

¹⁹ 海商法, promulgated on 7th November, 1992 and effective from 1st July, 1993.

²⁰ 票据法, promulgated on 10th May, 1995 and effective from 1st January, 1996; last revision effective from 28th August, 2004.

²¹ 继承法, promulgated on 10th April, 1985 and effective from 1st October, 1985.

²² See generally *DING Wei*.

²³ *WAN E'xiang* (ed.), 9-10.

²⁴ 最高人民法院关于贯彻执行民法通则若干问题的意见(试行), promulgated on and effective from 26th January, 1988; several articles abolished on 24th December, 2008.

viewed that Chapter 8 of the GPCL, together with the Opinions on GPCL, form the foundation of private international law.

Aside from domestic law rules, China also concluded many bilateral agreements²⁵ and acceded to various international treaties.²⁶ Although China did not accede to any special treaties on conflict of laws, many of the treaties to which China is a party contain rules on private international law. These international treaties provided a source for China's modern private international law.²⁷

IV. LAL

The LAL, composed of 8 chapters and 52 articles, is the first uniform and **14** comprehensive private international code of China. It serves several major purposes: (1) to identify laws applicable to foreign-related civil relations, (2) to reasonably settle foreign-related civil disputes, and (3) to safeguard legal rights of the disputants.²⁸ The LAL, in the legislative sense, is deemed as a cornerstone of private international law and, in the scholarly sense, a culmination of the study of private international law in China.²⁹ In a practical sense, it not only codifies the existing fragmented rules on private international law, but also represents the latest development of private international law and is thus an indispensable contribution to China's legal system.³⁰ Yet, due to the short history of the LAL, the practical applicability of the LAL has not been sufficiently tested. Thus, at this point in time, it is premature to decisively conclude whether the LAL is truly a success or simply a new start for the development of private international law. Several issues should nevertheless be highlighted with regard to the scope of application, structure, basic principles, and normative status of the LAL.

15

²⁵ For instance, the Bilateral Agreement on Civil, Commercial, and Criminal Judicial Assistance between the PRC and the Arab Republic of Egypt (和阿拉伯埃及共和国关于民事、商事和刑事司法协助的协定), promulgated on 29th December, 1994 and effective from 31st May, 1995, includes an article dealing exclusively with jurisdictional issues in civil and commercial cases.

²⁶ For instance, China ratified the 1965 Hague Convention on the Service Abroad of Judicial and Extra-Judicial Documents in Civil and Commercial Matters in 1991 and the Convention came into force with respect to China on 1st January, 1992.

²⁷ A non-exhaustive list of such international agreements and treaties may be found on the official website of China's Foreign Ministry at http://www.fmprc.gov.cn/mfa_chn/ziliao_611306/tytj_611312/.

²⁸ WAN E'xiang (ed.), 9-11.

²⁹ HUANG Jin. 3.

³⁰ WAN E'xiang (ed.), 3.

First, as suggested by its title, the LAL exclusively addresses the issues of law in foreign-related civil relations. The term “foreign-related” stands in the center of the LAL. Despite the frequent appearance of this term, Chinese law does not have a clear definition therefor. Guidance may be found in the Opinions on GPCL. For instance, according to art. 304 of the Opinions of the SPC on Certain Issues Arising from the Application of the Civil Procedural Law of the PRC (Opinions on CPL)³¹, if a case meets any of the three requirements, it will be deemed as foreign-related: (1) one of the parties is or both parties are foreigner(s), stateless person(s), foreign enterprise(s), or organization(s); or (2) the legal relation is established, modified, or terminated outside the territory of China; or (3) the subject matter of the case lies outside the territory of China. With reference to this provision, one may find that China actually adopts a broad operative definition of the term “foreign-related”. Besides, in light of the enhanced convenience of international communications, it is often quite easy to change the nature of civil relations from domestic to foreign-related by simply modifying or creating proper connecting factors. For instance, two Chinese companies may conclude a foreign-related contract through their subsidiaries or agencies in Hong Kong or elsewhere, without changing any of their substantive contractual rights and obligations.

- 16** Second, as a comprehensive code, the LAL has a broad coverage. It not only contains general rules on private international law (Chapter 1), but it also prescribes concrete rules with respect to specific types of civil relations, such as persons (subjects of civil legal relations, Chapter 2), marriage and family (Chapter 3), succession (Chapter 4), property rights (Chapter 5), obligations (Chapter 6), and intellectual property rights (Chapter 7). It is also worth mentioning that China only recognizes foreign substantive laws, but not foreign rules on conflict of laws.³²
- 17** Thirdly, the LAL has codified several basic principles of private international law, namely, the closest connection principle, the party autonomy principle, and the mandatory rules on principles of precedence and public policy reservation. Particularly, the closest connection principle not only serves as one of the many rules on conflict of laws in the LAL, it also serves as a catch-all provision. Therefore,

³¹ 最高人民法院关于适用民事诉讼法若干问题的意见, promulgated on and effective from 14th July, 1992, last revision from 24th December, 2008.

³² Art. 9 LAL.

in cases where the LAL is silent in regards to laws applicable to foreign-related civil relations, the applicable law is to be determined by the closest connection principle.

Fourthly, the normative status of the LAL within the Chinese legal system is also **18** worth mentioning. Despite being the first code of private international law, the LAL does not necessarily prevail over the rules on private international law as found in various other laws. The normative status of the LAL vis-à-vis other laws has been recognized by art. 2 LAL. According to this provision, the law applicable to foreign-related civil relations shall be determined in accordance with the LAL. If other laws provide special rules for determining the law application to such relations, then these rules shall prevail. Yet, the LAL does state the exact meaning of such “other laws”. Generally, these laws refer mainly to the Maritime Law, the Civil Aviation Law³³, the Securities Law³⁴, and the CL.³⁵

Finally, the LAL is silent on the issue of application of international treaties in China. **19** According to art. 142 GPCL, if the relevant provisions of applicable Chinese national laws are in conflict with those contained in the international treaty to which China is a party, the latter shall prevail unless China makes a reservation.

V. China’s Private Interregional Law

Upon the handover of Hong Kong and Macao to China in 1997 and 1999, **20** respectively, China established the Hong Kong Special Administrative Region (Hong Kong SAR) and the Macao Special Administrative Region (Macao SAR). For historical reasons, these two SARs are socially, economically, and legally different from Mainland China. In order to maintain the stability of the SARs, China adopts the “One Country, Two Systems” policy (OCTS Policy), which is also embodied in the Basic Law of the Hong Kong SAR (HK Basic Law)³⁶ and the Basic Law of the Macao SAR (Macao Basic Law)³⁷. According to OCTS policy of these two basic

³³ 民用航空法, promulgated on 30th October, 1995 and effective from 1st March, 1996.
³⁴ 证券法, promulgated on 29th December, 1998 and effective from 1st July, 1999; last revision effective from 1st January, 2006.
³⁵ WAN *E’xiang* (ed.), 17.
³⁶ 香港特别行政区基本法, promulgated on 4th April, 1990 and effective from 1st July, 1997.
³⁷ 澳门特别行政区基本法, promulgated on 31st March, 1990 and effective from 20th December, 1999.

laws, both SARs are allowed to maintain their own legal systems for at least fifty years after the handover.³⁸

- 21** One typical legal impact of the OCTS Policy is that China shifted from being a country of sole-jurisdiction to being one of multi-jurisdiction. Specifically, Mainland China is generally deemed as a jurisdiction of civil law tradition, while the Hong Kong SAR is deemed as a typical jurisdiction of common law because of its British legal heritage. Although the Macao SAR may also be deemed as a jurisdiction of civil law tradition, due to its Portuguese governance in the past, its legal system maintains a substantive difference from that of Mainland China for other historical reasons. Given the difference of the legal systems of the three jurisdictions, conflicts of their laws seem inevitable, and calls for private interregional laws.³⁹
- 22** Admittedly, China is not the only country with multiple jurisdictions, and Chinese law does contain express rules to deal with such interregional issues. Two scenarios are to be briefly discussed here. At the international level, if the rules on conflict of laws direct the law of a foreign state with multiple jurisdictions, according to art. 6 LAL, the law of the jurisdiction with which the disputed civil relation bears the closest connection is applied. This also indicates that China only recognizes foreign substantive laws, but not foreign interregional rules on conflict of laws.⁴⁰ However, at the national level, when dealing with possible conflicts among the laws of Mainland, China, the Hong Kong SAR, and the Macao SAR, China considers the laws of the two SARs as “foreign laws”.

VI. Principles and General Rules of CPIL

- 23** As the first code of private international law in China, the LAL lays down several principles of private international law, which are codified in arts. 2-5. Admittedly, these principles have been developed over time in private international law and are, for the first time, systematically codified by the LAL. Their codification signifies China’s efforts to bring its private international law legislation and practice up to “international standard”. In addition, the LAL contains several general rules, which are applicable to all types of foreign-related civil and commercial relations.

³⁸ See Preamble, HK Basic Law; and Preamble, Macau Basic Law.

³⁹ See, *HAN Depei*, 4.

⁴⁰ See Art. 6 LAL; *WAN E'xiang*, 55.

1. Principles of Chinese Private International Law

First and foremost, the closest connection principle is highlighted in art. 2 LAL. It has **24** been suggested that the drafters of the LAL impliedly set this principle as the “fundamental principle” and “guiding thought” of the LAL.⁴¹ For the purpose of this book, there is no need to elaborate on the origin and development of this principle, suffice to say that this principle has been globally recognized. Yet, despite the fundamental significance of this principle, it is unclear how this principle is applied in practice. Indeed, in complicated transnational disputes, it could be difficult for judges to decide which connecting factor bears the closest connection with a dispute or agreement.

In general, such vagueness is left for the relevant SPC judicial interpretations. For **25** example, as will be discussed in more detail later on, art. 5 of the Rules of the SPC on the Relevant Issues concerning the Application of Law in Hearings on Foreign-Related Contractual Disputes in Civil and Commercial Matters (SPC Judicial Interpretation No. 2007-14)⁴² provides that, in cases where the parties failed to choose the law applicable to their contract, the law of the region or state with which the contract bears the closest connection, applies (*infra* Chapter 21 at 29 *et seqq.*).

Art. 3 provides that parties may choose the governing law of their foreign-related **26** civil relations. It has been suggested that the principle of party autonomy is the “quasi-fundamental” principle of private international law.⁴³ This principle has a long history. It was originally applied in the field of contract law, but over time, the scope of its application was expanded to other fields, such as disputes relating to tort, family, and real estate. This principle also has substantive and procedural limitations. A typical limitation is that parties are not allowed to choose a state law to replace otherwise applicable mandatory rules. As far as China is concerned, though art. 3 LAL clearly recognizes the principle of party autonomy, it does not provide for any operational rules, except that such a decision must be made in an explicit manner. Besides, according to various LAL provisions, parties may only choose the

⁴¹ WAN E'xiang, 20,24.

⁴² 最高人民法院关于审理涉外民事或商事合同纠纷案件法律适用若干问题的规定, promulgated on 23rd July, 2007 and effective from 8th August, 2007.

⁴³ WAN E'xiang, 26.

governing law of their civil relations from a limited number of state laws.⁴⁴ In addition, concerning the time necessary to make the applicable law choice, although the LAL is silent, according to art. 4 of the above SPC Judicial Interpretation No. 2007-14, the parties must make their decision no later than the hearing on the dispute by the first instance.

- 27** The third principle is the compulsory application of the mandatory rules of Chinese law, which is codified in art. 4 LAL. This is the first codification of this principle in Chinese law, although this principle has been established in judicial practice. The general consensus is that these rules serve the purpose of protecting public order and forum state interests, thus their application has priority over the parties' choice of law. In Chinese law, there are also such mandatory rules. For instance, art. 126 CL provides that Chinese law will exclusively govern several types of contracts if they are performed within China's territory (*infra* Chapter 21 at 25). Yet, it must be noted that the LAL and other Chinese laws neither define the term "mandatory rules" nor provide guidance for judges to help identify such rules. Thus, due to its vagueness, it is possible that this principle could be abused in practice.
- 28** Finally, art. 5 LAL provides reservation in respect of state interests. According to this provision, in cases where the application of foreign law is harmful to state interests of China, Chinese law applies. This reservation is often enshrined in mandatory rules, thus arts. 4 and 5 LAL may overlap in their application in practice. Similarly, Chinese law fails to provide any definition of state interests or guidance to help judges identify them. It is argued that state interests should be understood in the particular state law system and on an individual basis, chiefly based on the social and cultural backgrounds rooted in that state. However, there are concerns that courts could easily abuse such reservations, as the term "state interests" is often too vague to be clearly identified in practice. For instance, China has many state-owned enterprises (SOEs), many of which are under direct management and supervision of the State Council. Although the SOEs are generally deemed as independent legal persons *de jure*, it is often disputed if their interests could be deemed as state interests. Such debates not only touch upon the definition of state interests, they also indirectly target at the enterprise management system and economic regime of

⁴⁴ See, e.g. 26, 49, and 50 LAL.

China. For these reasons, one is likely to suggest that, in practice, the term “state interests” must be narrowly interpreted to avoid the possible abuse thereof.

2. General Rules of Chinese Private International Law

Aside from the principles mentioned above, the LAL also contains several general 29 rules on private international law, which are mainly codified in art. 7-10 LAL. Judging from the structure of the LAL, these rules govern all types of foreign-related civil and commercial relations, and thus acquire generality in application. Although these rules are technical in nature, they may make substantial difference in practice. According to art. 7, the law governing statutes of limitation is the applicable law of the foreign-related civil relations in dispute. Besides, pursuant to art. 8 LAL, the law governing the characterization of foreign-related civil relations is the *lex fori*.

Art. 9 LAL deals with the legal figure of *renvoi*. According to this provision, the 30 applicable laws referred to in the LAL should be deemed as substantive laws only. Obviously, the LAL explicitly denies *renvoi*. Despite heated academic debates, this provision reflects China’s consistent position of applying only foreign substantive laws. This can also be seen in various SPC judicial interpretations of the GPCL. For instance, art. 178 of the Opinions on GPCL provides that the term “applicable foreign law” shall refer exclusively to foreign substantive law.

At last, art. 10 LAL deals with the identification of foreign laws. According to this 31 provision, the task of identifying foreign laws should be undertaken by courts and arbitration institutions, while the parties bear the burden of providing the foreign laws, if they choose to apply them. In cases where the foreign laws cannot be identified or cannot solve the dispute, Chinese laws shall be applied. Judging from this provision, the drafters of the LAL seem to deem foreign laws as laws instead of facts. From the procedural perspective, one of the main differences between law and fact is that courts are generally required to identify laws, while parties usually bear the burden to prove facts.

Such a technical issue is important in practice, yet it also raises concerns. For 32 instance, art. 10 LAL fails to provide any methods or procedures for courts and arbitration institutions to identify foreign laws. Thus, one may doubt whether foreign laws can be identified efficiently and correctly. One may also worry whether the courts would wrongfully apply Chinese law with the excuse that they could not

identify the applicable foreign law, because Chinese judges, particularly those in less developed regions, are not familiar with handling foreign-related disputes, and the identification of foreign laws could be a huge challenge and burden to them. Admittedly, there are no fixed solutions to these questions, and efficient and correct application of the provision depends largely on Chinese courts.

VII. Recognition and Enforcement of Foreign Judgments and Arbitral Awards

- 33** With the opening up of China, foreign-related civil and commercial litigation and arbitration have become a regular part of Chinese law. Recognition and enforcement of foreign judgments and arbitral awards have therefore become a practical need for Chinese citizens and foreigners alike. It should be noted that the Hong Kong and Macao SARs are deemed as “foreign” under Chinese law. Thus, judgments and arbitral awards which originate from these SARs, though subject to different legal frameworks, are recognized and enforced as foreign judgments and arbitral awards from a practical perspective.

1. Recognition and Enforcement of Foreign Arbitral Awards

- 34** As far as foreign arbitral awards are concerned, China is a party to the Convention of Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) and Chinese courts bear a treaty obligation to recognize and enforce qualified foreign arbitral awards.⁴⁵ Currently, the New York Convention has 148 contracting states. Therefore, it is fair to say that this Convention realizes “free movement” of arbitral awards globally, which is widely deemed as the key advantage of international arbitration vis-à-vis transnational litigation.
- 35** When acceding to the New York Convention in 1958, China made two reservations: (1) the commercial reservation, meaning that China will apply the Convention only to differences arising out of legal relationships, whether contractual or not, that are considered commercial under the national law; and (2) the reciprocity reservation, meaning that China will apply the Convention only to recognition and enforcement of awards made in the territory of another contracting state.

⁴⁵ Art. 2 of the New York Convention.

The legal framework of recognition and enforcement of foreign arbitral awards in China is quite complicated and constantly changing.⁴⁶ In general, such legal framework is composed of the special chapters of the CPL, the Arbitration Law, and a series of SPC judicial interpretations. In short, art. 267 CPL provides that the parties may apply for enforcement of an arbitral award rendered by foreign arbitration institutions to the Intermediate Court of the place where the award-debtor's domicile or properties are located. The court must enforce such awards in accordance with the provisions of the relevant international treaty to which China is a party (this mainly refers to the New York Convention) or the principle of reciprocity. Besides, to better guide Chinese courts to recognize and enforce foreign arbitral awards in accordance with the New York Convention, the SPC has issued a series of judicial interpretations, which touch upon various technical and operational aspects, such as procedures, time limitation, and review standards of the foreign arbitral awards.⁴⁷

As far as the Hong Kong SAR and Macao SAR are concerned, the New York Convention was applicable to them by extension through Britain and Portugal during the colonial period of both SARs. However, after their handover to China, China failed to extend the application of the New York Convention to these SARs. Instead, mutual recognition and enforcement of arbitral awards are governed by the special arrangements between the SPC of China and the two SARs.⁴⁸ These arrangements are “old wine in new bottles” because, although they are in the form of SPC judicial interpretations, they have essentially duplicated the core rules of the New York Convention.

⁴⁶ For a general discussion on recognition and enforcement of foreign-related and domestic arbitral awards, refer to *Chi Manjiao*, Drinking Poison to Quench Thirst: The Discriminatory Arbitral Award Enforcement Regime under Chinese Arbitration Law, 39 (2) Hong Kong L. J. 541 (2009).

⁴⁷ See, e.g. Notice of the SPC on Enforcing the Convention of Recognition and Enforcement of Foreign Arbitral Awards (最高人民法院关于执行我国加入的《承认及执行外国仲裁裁决公约》的通知), promulgated on and effective from 10th April, 1987; Opinions on CPL; and Notice of the SPC on Certain Issues concerning to the Handling of Foreign Arbitration and Foreign-Related Arbitration (最高人民法院关于人民法院处理与涉外仲裁及外国仲裁事项有关问题的通知), promulgated on and effective from 28th August, 1995, last revision effective from 31st December, 2008.

⁴⁸ See the Arrangement between Mainland China and the Hong Kong SAR on the Mutual Recognition and Enforcement of Arbitral Awards (最高人民法院关于内地与香港特别行政区相互认可和执行仲裁裁决的安排), promulgated on 24th January, 2000 and effective from 1st February, 2000; and the Arrangement between Mainland China and the Macau SAR on the Mutual Recognition and Enforcement of Arbitral Awards (最高人民法院关于内地与澳门特别行政区相互认可和执行仲裁裁决的安排), promulgated on 12th December, 2007 and effective from 1st January, 2008.

2. Recognition and Enforcement of Foreign Judgments

- 38** Compared with foreign arbitral awards, recognition and enforcement of foreign judgments by Chinese courts seem to be more difficult. This is mainly because China is not a party to any widely accepted international convention for the enforcement of foreign judgments.⁴⁹ Rather this issue is generally addressed by either bilateral treaties of judicial assistance or domestic laws.
- 39** The general rules of recognition and enforcement of foreign judgments are provided in a special chapter of the CPL. Arts. 265 and 266 CPL form the basis of the legal framework of recognition and enforcement of foreign judgments. According to art. 265 CPL, there are two major methods to be applied in Chinese courts for the enforcement of an effective foreign judgment or decision: (1) the parties may apply to the competent Intermediate Court for enforcement, (2) the foreign court may also request enforcement from the court in accordance with provisions of the relevant international treaty to which China is a party (mainly refers to Sino-foreign bilateral judicial assistance treaties) or in accordance with the principle of reciprocity. Art. 266 CPL further provides that upon the request of the parties or of the foreign courts, the court must review such judgments or decisions and reserve the right to refuse enforcement if such enforcement would hurt China's state sovereignty, security or social and public interests. However, despite the above provisions, Chinese domestic law is largely silent as to the procedures of recognition and enforcement of foreign judgments and decisions. This problem is left to be solved by the relevant bilateral treaties of judicial assistance, SPC judicial interpretations, and the discretion of the courts on a case-by-case basis.
- 40** Concerning the mutual recognition and enforcement of judgments originating from the Hong Kong and Macao SARs, since the SARs are deemed as foreign and are entitled to the power of final adjudication, their judgments are deemed as foreign judgments. Due to this reason, the SPC has also concluded special arrangements with the SARs to address this issue.⁵⁰

⁴⁹ Notably, China is not a party to the *Convention on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters*, adopted at Hague Conference on Private International Law on 1st February, 1971, or other similar international treaties in this regard.

⁵⁰ See The Arrangement between Mainland China and the Hong Kong SAR on the Mutual Recognition and Enforcement of Civil and Commercial Judgments in Cases of Consensual Jurisdiction (最高人民法院关于内地与香港特别行政区法院相互认可和执行当事人协议管辖的民商事案件判决的安排)

), promulgated on 3rd July, 2008 and effective from 1st August, 2008; and the Arrangement between Mainland China and the Macau SAR on Mutual Recognition and Enforcement of Civil and Commercial Judgments (最高人民法院关于内地与澳门特别行政区相互认可和执行民商事判决的安排), promulgated on 21st March, 2006 and effective from 1st April, 2006.

Chapter 19. Subjects of Civil Relations

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I. General Introduction

- 1 Under Chinese law, subjects of civil relations usually include natural persons and legal persons (*supra* Chapter 2 at 1 *et seqq.*). In exceptional cases, states and international organizations may also be subjects of civil relations and are thus governed by private international law. To both natural and legal persons, it is imperative to have proper legal capacities in order to engage in civil conducts, otherwise, their acts may be deemed legally invalid. In China, major legal instruments with regards to persons include the GPCL, the Nationality Law¹, the

¹ 国籍法, promulgated on and effective from 10th September, 1980.

Company Law ² , their related rules on implementation, and SPC judicial interpretations.

In addition, certain distinctive Chinese issues may also complicate Chinese law ² concerning persons, both substantively and procedurally. For instance, as mentioned, China has multiple jurisdictions and the Hong Kong SAR and Macao SAR, though part of Chinese territory, are deemed as foreign in civil relations. Another example is the long but notorious system of household registration in the PRC, known as “huji” (户籍) or “hukou” (户口) in Chinese (*infra* at 8). This system draws a clear line between groups of Chinese citizens, which not only creates inequality among citizens, but also leads to problems of procedural law. A third example is the complicated and confusing classification of legal persons in China, some types of which do not have counterparts in the legal systems of other states.

II. Natural Persons

Natural persons are probably the most predominant type of subjects in civil ³ relations. They thus seem to be an appropriate point at which to start an analysis.

1. Legal Capacity for Civil Rights

In essence, a natural person’s capacity for civil rights is a legal term with a broad ⁴ meaning. Art. 9 of the GPCL clearly states that a natural person’s capacity for civil rights shall start from his birth and last for the entirety of his lifetime. Art. 10 of GPCL further provides that all citizens are equal with regards to their capacities for civil rights. State laws often differ with regards to a natural person’s capacity for civil rights. For instance, states may provide different legal standards for determining the time of “birth” and the time of “death” of a natural person. To solve such conflicts, it is generally agreed that the law governing a natural person’s capacity for civil rights is his personal law (*lex personalis*), although other solutions exist. In practice, such *lex personalis* may refer to either the national law of the natural person (*lex patriae*) or the law of his domicile (*lex domicilii*). This is mainly because a natural person’s nationality and domicile often bear close connection with his capacity for civil rights.

² 公司法, promulgated on 29th December, 1993 and effective from 1st July, 1994; last revision effective from 1st January, 2006.

Besides, in certain cases, the law of the state where the court is located (*lex fori*) may also be applied to solve such conflicts of laws. It is thus necessary to briefly discuss the issues of nationality and domicile of a natural person as well as their legal significance in the context of private international law.

- 5 Although Chinese law does not contain express provisions with regards to the law applicable to decide a natural person's capacity for civil rights, it would be natural to understand that his *lex personalis* is applied by virtue of general practice. When deciding the *lex personalis* of a natural person, recent developments of private international law clearly show a preference for *lex domicilii* over *lex patriae*. Art. 65 of the Model PIL provides that the law applicable to a natural person's capacity for civil rights is the law of his domicile or that of his habitual residence. This position is deemed as a reflection of the prevailing closest connection principle in private international law and was later adopted by art. 11 LAL. This article provides that a natural person's capacity for civil rights is determined in accordance with his *lex domicilii*. In a sense, China's growing preference for *lex domicilii* is a proof of its recognition and acceptance of the international trend of free trans-boarder movements of people.³
- 6 It should be mentioned that the concept of *lex domicilii* under Chinese law has a special meaning due to China's unique concept of "huji" (*infra* at 8). According to art. 15 GPCL, the domicile of a natural person is the place where his "huji" is seated; if the place of his "huji" is different from his habitual residence, the latter is deemed as his domicile. The GPCL has no clear definition of habitual residence. According to art. 5 of the Opinions of the SPC on Certain Issues Arising from the Application of the Civil Procedural Law of the PRC (Opinions on CPL)⁴, the habitual residence of a natural person is the place where he has stayed continuously for over one year from the time he left his domicile to the time he was sued, excluding any place where he may have received medical treatment. As can be seen, when determining the habitual residence of a natural person, Chinese law only considers the duration of his residence, but ignores his intention of residence. For such reason, it is

³ WAN E'xiang, 93.

⁴ 最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见, promulgated on and effective from 14th July, 1992; last revision effective from 24th December, 2008.

suggested that China’s concept of habitual residence is inconsistent with international practice.⁵

Private international law further provides solutions for both negative and positive 7 conflicts of domiciles. Specifically, concerning negative conflicts of domiciles, the former half of art. 183 of the Opinions of the SPC on Certain Issues concerning the Implementation of the General Principles of Civil Law of the PRC (Trial) (Opinions on GPCL)⁶ stipulates that, if a natural person’s habitual residence cannot be determined, his current residence will be regarded as his habitual residence. This approach was later substantially codified by art. 20 of the LAL. In practice, identifying the *lex domicilii* of a natural person is typically a last resort, meaning that the law of the present residence will be applied only when the habitual residence cannot be ascertained and there is no other law to be applied.⁷ With regards to positive conflicts of domiciles, according to the latter half of art. 183 of the Opinions on GPCL, if a natural person has two or more habitual residences, his habitual residence will be the one with which he has the closest connection. The LAL is silent on this issue.

2. China’s Unique “Huji” System and Private International Law

The “huji” system has a long history in China. Essentially, this system fixes a person 8 to a certain place, usually his place of birth, and denies his right to free movement, thereby creating a stable and permanent connecting factor. By stabilizing a person’s social relations, this system mainly serves the purpose of social control of individuals, tax collection, and crime prevention.⁸

The “huji” system was maintained by the PRC to play a similar function of social 9 governance. This system also impliedly categorizes persons into urban and rural citizens, who are respectively governed by different regimes, have different rights, and bear different obligations. Such a distinction influences almost every aspect of a person’s life, such as his medical care, education, and employment. Consequently, the “huji” system creates *de facto* social segregation and discrimination, and thus

⁵ WAN E’xiang, 94; HUO Zhengxin, 62.
⁶ 最高人民法院关于贯彻执行民法通则若干问题的意见(试行), promulgated on and effective from 26th January, 1988; several articles abolished on 24th December, 2008.
⁷ WAN E’xiang, 154;
⁸ ZHU Lijiang, 541-542; HUO Zhengxin, 63.

constitutes a gross violation of both China's Constitution and international human rights law.⁹

- 10** Although the “hujī” system has not been formally abolished, it has been seriously challenged since China adopted the economic reform and opening-up policy in the late 1970s. This is because the reform actually requires free movement of persons and resources, which contradicts the very nature of the “hujī” system. Such a contradiction is particularly sharp considering that, nowadays, many Chinese, in particular a huge number of migrant workers, are working and living in places other than their place of “hujī”. Therefore, the linkage between a citizen's place of “hujī” and his domicile or residence is substantially diminishing. However, as the *lex domicilii* of a natural person is still largely dependent under Chinese law on his “hujī”, there is an urgent need for China to fundamentally change its notorious “hujī” system.

3. Nationality of Natural Persons

- 11** As a legal term, nationality represents the bond between a state and its nationals and therefore carries great significance in both international and domestic law. In international law, nationality determines the scope of application of basic rights and the obligations of states vis-à-vis other states and the international community, such as personal jurisdiction, the application of treaties, and diplomatic protection. In domestic law, nationality is a fundamental requirement for the exercise of political rights and claims to protection and correlates duties, such as military or civil service obligations, which may, however, vary according to national law.¹⁰ Indeed, as *Brownlie* has insightfully pointed out, the issue of nationality has traditionally been dealt with by municipal laws.¹¹
- 12** This chapter will briefly discuss the Chinese law on nationality, including the acquisition and loss of nationality, and the approach to deal with conflicts of nationalities. In practice, these two issues are often interrelated.

⁹ *ZHU Lijiang*, 563-565.

¹⁰ *HAILBRONNER*, 36.

¹¹ See *BROWNLIE*, 284-285.

Regarding the acquisition and loss of nationality, according to the Nationality Law, a 13
natural person may acquire Chinese nationality by birth, naturalization, or
restoration. Art. 5 provides that a person acquires Chinese nationality by birth if both
or even one of his parents is a Chinese national. Art. 8 provides that a person who
applies for naturalization as a Chinese national acquires Chinese nationality and will
not be allowed to retain his foreign nationality upon approval of his application. Art. 9
provides that a Chinese national who is voluntarily naturalized to be a foreign
national or acquires foreign nationality will automatically lose his Chinese nationality.
According to art. 13, if a Chinese national who has been naturalized wants to restore
his Chinese nationality, he may apply so; if his application is approved, he will not be
allowed to retain his foreign nationality.

Conflicts of nationalities are caused by inconsistent rules of acquisition and loss of 14
nationality in different state laws. Such conflicts can generally be categorized into
two types: (1) positive conflicts and (2) negative conflicts. The former refers to
situations of dual nationality, where a person has nationalities of more than one
state, while the latter refers to a situation where a person has no nationality and is
stateless. In either situation, rules on private international law are needed to solve
conflicts.

Concerning negative conflicts of nationality, the Opinions on GPCL are silent, while 15
the latter half of art. 19 of the LAL provides that the *lex patriae* of a stateless person
whose nationality cannot be ascertained is the law of his habitual residence. This
provision could be problematic in practice, because it is possible that a stateless
person may have no habitual residence at all considering that, as mentioned above,
art. 5 of the Opinions on CPL requires that habitual residence of a natural person is
the place where he has stayed continuously for over one year from the time he left
his domicile to the time he was sued.

Concerning positive conflicts of nationality, art. 182 of the Opinions on GPCL 16
provides that if a foreign natural person has dual or multiple nationalities, his *lex
patriae* will be the law of his domicile or the law of the state with which he has the
closest connection. Although this provision is in line with international practice, it
fails to take into consideration the situation where one of his nationalities is

Chinese.¹² This problem is particularly thorny considering the recent issue of *de facto* dual nationality of many Chinese citizens, although art. 3 of the Nationality Law clearly bans dual nationality.

- 17 The so-called *de facto* dual nationality is mainly caused by China's "automatic loss of nationality" policy, as shown in art. 9 of the Nationality Law. In practice, this approach imposes an obligation on a naturalized Chinese citizen to request the relevant Chinese authorities to revoke his "hujia" in order to effectuate his loss of Chinese nationality. Yet, it is extremely difficult for Chinese authorities to detect persons who have acquired foreign nationalities but failed to report it. As a matter of fact, many Chinese citizens holding foreign passports still appear on the official records of Chinese authorities, because their "hujia" has not yet been revoked. As a result, such persons become a *de facto* dual national of China and other states. Such a phenomenon has attracted wide attention recently because many "dual nationals" are reported to serve as Chinese congressmen (members of the National People's Congress), and because such loopholes in Chinese law also leave the door wide open for many corrupted public officials to flee China without being punished.¹³
- 18 On the issue of dual nationality, the first half of art. 19 LAL represents an improvement to art. 182 of the Opinions on GPCL. Art. 19 provides that if a natural person has dual or multiple nationalities, his *lex patriae* will be the law where his habitual residence is seated; if he has no habitual residence in any of his national states, his *lex patriae* will be the law of his national state with which he has the closest connection. Though this provision can partly solve the issue of *de facto* dual nationalities of Chinese citizens, it still fails to expressly prioritize Chinese law when determining the *lex patriae* of such persons.¹⁴

4. Legal Capacity for Civil Conducts

- 19 A natural person's capacity for civil conducts decides whether he can legally commit certain civil acts. Generally, depending on age and mental conditions, a natural

¹² Yu Fei, 257.

¹³ See, e.g. Xinhua News Agency, Member of the Standing Committee of the National People's Congress Suggests Removal of "Dual Nationality" (全国人大常委会委员建言消除“双重国籍”), available at http://news.xinhuanet.com/2012-04/26/c_123043801.htm.

¹⁴ Chinese Society of Private International Law, 118.

person can be granted full capacity, limited capacity, or no capacity for civil conducts. In almost all jurisdictions, a natural person must be an adult and mentally healthy to be granted full capacity for civil conducts; minors and those with damaged mental conditions will only be granted limited capacity or no capacity for civil conducts. In China, the relevant provisions include arts. 11-14 GPCL (*supra* Chapter 1 at 4 *et seqq.*).

As state laws are diverse with regards to adulthood and the mental conditions of 20 natural persons, in international settings, a natural person who has full capacity for civil conducts in one country may very well be deemed as one with limited capacity in another. To solve such conflicts, it is suggested that Chinese law take a “two-step approach” when determining the applicable law: (1) to decide whether the person’s capacity for civil conducts in question is general or specific in nature, (2) to decide what conflict of laws rule should be applied depending on the nature of the capacity.¹⁵ However, this approach is theoretical and lacks practicability, as Chinese law does not contain express provisions regarding the nature of the capacity for civil conducts. Rather, the general practice of Chinese law seems to be the “opt-out approach”, i.e. unless otherwise provided, a natural person’s capacity for civil conducts is governed by his *lex personalis*.¹⁶ Specifically, according to art. 12 LAL, a natural person’s capacity for civil conducts is governed by the law of his habitual residence. If, under the law of his habitual residence, a natural person lacks capacity for a certain conduct, but would have capacity under the law of the place where such conduct is committed, the law of the place of commission applies, except for conducts concerning family, marriage, or succession. In a sense, this article also reflects China’s preference for the principle of closest connection in deciding the *lex personalis*.

Chinese law contains concrete rules dealing with conflicts of a natural person’s 21 capacity for civil conducts. Art. 143 GPCL provides that if a citizen of China resides in a foreign country, the law of that country may apply to determine his capacity for civil conduct. This provision has been criticized for lack of accuracy and completeness. Some scholars suggest that it only deals with the situation where a Chinese national lives abroad, but fails to consider the situation where a foreign

¹⁵ WAN E’xiang, 100.

¹⁶ WAN E’xiang, 96.

national lives in China. Some suggest that the term “reside” is vague in the legal sense since it can mean abode, residence, or domicile. Others suggest that it is only permissive and by using the term “may apply” it fails to deal with situations where such laws cannot be applied.¹⁷

- 22** To cure the vagueness of this provision, arts. 179-181 of the Opinions on GPCL provide certain guidance. According to art. 179, for a Chinese national who settles in a foreign state, any conducts committed within Chinese territory may be governed by Chinese law and any conducts committed in a foreign state may be governed by the law of that state. Art. 181 deals with the special situation of a stateless person, providing that the law applicable to the capacity for civil conducts of a stateless person is the law of the state where he settles; if he has no settlement, the applicable law will be the law of the state of his domicile. Obviously, these provisions make up for the lack of clarity in art. 143 GPCL regarding foreign nationals and stateless persons. In addition, arts. 179-181 also show that, concerning the governing capacity for civil conducts, private international law clearly favours the *lex personalis*.
- 23** Apart from its clear preference for *lex personalis*, private international law contains some exceptions. Such exceptions are scattered into many laws and regulations and can be roughly classified into two types. At the outset, one may find a general enunciation of these exceptions in art. 12 LAL, which includes conducts concerning marriage, family, and succession. On this issue, art. 67 of the Model PIL even extends this list of exceptions to conducts of disposing of real estate properties. According to the drafters of the Model PIL, conducts concerning marriage, family, and succession are closely connected with the legal status of a natural person, public order, and conducts of disposing of real estate properties bear a close relationship with state sovereignty and interests. Thus, they should not be governed by a natural person’s *lex personalis*.¹⁸
- 24** Another example of such an exception can be found in art. 180 of the Opinions on GPCL. According to this provision, if a foreign national, who according to the law of his state has no capacity for civil conducts, but according to Chinese law does have this capacity, commits civil conducts within the Chinese territory, he will be deemed

¹⁷ See, generally, Yu Fei, 275.

¹⁸ Chinese Society of Private International Law, 122.

to have some degree of capacity for civil conducts. This provision is aimed at protecting good faith third parties who engage in civil activities with foreign nationals, such as concluding a commercial contract.¹⁹

III. Legal Person

Generally, legal persons, also known as juridical persons, are entities of various types established in accordance with the applicable state laws. Similar to natural persons, the nationality and domicile of a legal person are important factors in deciding its legal capacity. Today, legal persons, transnational corporations in particular, are probably the most prominent participants of international commercial activities. In this respect, state laws often differ concerning a legal person's legal capacities, qualifications, internal relations, and various other aspects. Furthermore, with the unprecedented expansion of international business transactions nowadays, it is imperative to discuss the rules on conflict of laws with regards to legal persons. At the outset, it is to note that arts. 36 and 39 of the GPCL explicitly provide the definition and qualification of a legal person. **25**

1. Nationality of a Legal Person

In practice, depending on the connecting factors, the nationality of a legal person can be decided by various approaches: **26**

(1) The nationality of a legal person may be decided according to its domicile. **27** Generally, the domicile of a legal person is its management or business center. However, this method is criticized for a lack of predictability, because under many state laws, it is quite easy for a legal person to change its domicile.

(2) The nationality of a legal person may be decided according to its registration or place of establishment. The advantage of this approach is its predictability, the disadvantage is that it may easily cause dual or multiple nationalities of a legal person since a legal person may be registered concurrently in several states. **28**

(3) The nationality of a legal person may be decided according to the nationality of its controlling shareholders. This approach is based on the rationale that legal rights and obligations of a legal person are ultimately taken by natural persons. Despite its **29**

¹⁹ See, *WAN E'xiang*, 98.

reasonableness, this approach is defective, because it is often difficult to tell precisely who is controlling a legal person in practice.

- 30** (4) The nationality of a legal person may be decided according to the law under which it is established. Although this is an easy method used to identify the nationality of a legal person, it may be easily evaded, because it is quite easy to establish a legal person in many states in today's world.
- 31** Two general trends need to be noted. First, depending on their specific needs, a state often applies multiple criteria simultaneously to determine the nationality of a legal person. For instance, a legal person may be granted the nationality of a state if it is registered in accordance with the law of that state and has domicile therein.²⁰ This seems similar to art. 1 of the 1956 Convention Concerning the Recognition of the Legal Personality of Foreign Companies, Associations and Institutions, which essentially provides that a contracting state should recognize the personality of a legal person if it is registered and has its office in another contracting state.²¹ Chinese law also adopts a similar combined approach when determining the nationality of a legal person (*infra* at 33 *et seq.*).
- 32** Second, the boom of a large number of transnational corporations in recent years also challenges the traditional approach of determining their nationality. Generally, transnational corporations are composed of a parent company and various subsidiaries. As they are often located in different states and are independent legal persons, the domiciles and management centres of transnational corporations are scattered. The proliferation of legal persons at the global level and the complication of their internal structures have made it increasingly difficult to determine their nationalities by the traditional approaches mentioned above.
- 33** In general, Chinese law adopts different criteria in determining the nationality of foreign and domestic legal persons. With regards to foreign legal persons, Chinese law does not provide for any explicit test to determine nationality. Yet, art. 184 of the Opinions on GPCL provides that “the *lex personalis* of a foreign legal person is the law of its place of registration, and its capacity for civil conducts is decided in accordance with its *lex personalis*.” This provision indirectly shows that Chinese law

²⁰ See, e.g. *Li Shuangyuan*, 407.

²¹ See http://www.hcch.net/index_en.php?act=conventions.text&cid=36.

adopts the “place of registration test” to determine the nationality of a foreign legal person.²²

With regards to domestic legal persons, Chinese law does not contain any general 34 rules. Art. 41 GPCL contains a provision dealing exclusively with the three major types of foreign investment companies. According to this provision, sino-foreign equity joint ventures, sino-foreign contractual joint ventures, and foreign investment companies established within Chinese territory that meet the requirements of legal persons, acquire a Chinese legal person status upon approval of the relevant commercial and industrial authorities. It can be seen that Chinese law adopts a “combined test” method, by which a legal person of Chinese nationality must be established within China and in accordance with Chinese law. Such tests have been made explicit by the Rules on the Implementation of Law in Sino-Foreign Equity Joint Ventures (Rules on Implementation)²³. According to art. 2 of the Rules on Implementation, sino-foreign equity joint ventures established in Chinese territory in accordance with the Rules on Implementation shall be deemed as Chinese legal persons.

2. Domicile of a Legal Person

State laws have different criteria used to determine the domicile of a legal person. In 35 brief, some state laws deem the management center of a legal person as its domicile. This is predictable, but can be easily evaded since a legal person may legally establish its management centre in different places. Some deem the business or operation center of a legal person as its domicile. This test lacks predictability because a legal person, particularly a transnational corporation, may have more than one business centre. Some deem the administration centre of a legal person as its domicile, which could be its business or management centre. Finally, some state laws deem the registration place of a legal person as its domicile. Yet the registration place may have little connection with the legal person in today’s commercial practice.²⁴

²² See *Yu Fei*, 282.

²³ 中外合资经营企业法实施条例, promulgated on and effective from 20th September, 1983; last revision effective from 22nd July, 2001.

²⁴ See generally *Yu Fei*, 280-282.

36 Chinese law adopts a third test, namely, the test of administration office. This is not only supported by mainstream scholars, but is also codified in various laws and rules. For instance, art. 63 of the Model PIL, art. 39 GPCL, and art. 10 of the Company Law all contain nearly identical rules regarding the domicile of a legal person. According to these provisions, the domicile of a legal person, or a company in the context of the Company Law, is the place where its main administrative office is located. However, Chinese law is silent as to what constitutes the main office in cases where a legal person has more than one administrative office.

3. Capacities of Legal Persons

37 Similar to a natural person, a legal person also possesses the capacity for both civil rights and civil conducts. It is generally agreed that a legal person's capacity for both civil rights and civil conducts starts from the time when it is legally established and terminates from the time it is legally terminated. In this regard, Chinese law generally does not draw a clear distinction between foreign and domestic legal persons. Therefore, the rules on a legal person's capacity for civil rights and civil conducts apply to both domestic and foreign legal persons, except otherwise indicated.

38 The general rule on conflict of laws regarding a legal person's capacity for civil rights and civil conducts can be found in the LAL. According to art. 14 LAL, the law of the place where a legal person is registered governs its capacity for civil rights and civil conducts, organizational structure, shareholders' rights and obligations, and other issues of the legal person or its branches. In cases where the place of registration and the main place of business of a legal person fall apart, the law of the latter is applied. The habitual residence of a legal person is deemed as its main place of business. Obviously, the wording "other issues" implies that this provision deals with a broad range of issues in relation with a legal person, including, but not limited to, its capacity for civil rights and civil conducts.²⁵

39 Furthermore, it must be mentioned that this rule not only applies to a legal person, but also extends to its branches, which is deemed as an innovation of Chinese law.²⁶ The incorporation of this provision is meant to bring Chinese law apace with

²⁵ WAN E'xiang, 112.

²⁶ WAN E'xiang, 113.

its practical needs. In recent years, with China's ongoing opening up and economic reform, particularly after China's accession to the WTO, an increasing number of foreign and transnational companies were keen to establish branches and representative offices in China. It is thus necessary for Chinese law to provide explicit rules to govern such issues. In fact, Chapter 9 of the Company Law contains various concrete provisions which deal with the requirements and procedures necessary to set up branches and establish the basic principles necessary for the branches to engage in commercial activities in China.

The above LAL provision was modified from the Model PIL, though the latter is not a **40** binding legal instrument. Arts. 68 and 69 of the Model PIL deal with a legal person's capacity for civil rights and civil conducts, respectively. According to art. 68, the law of the place where it is incorporated or where it has its main administrative office governs a legal person's or other organization's capacity for civil rights. Art. 69 provides that a legal person's or other organization's capacity for civil conducts is governed by multiple laws, including the law of its incorporation or main place of management and the law of the place of commission of the conducts.

As can be seen, the main difference between the LAL and the Model PIL provisions **41** lies in that the former shows a clear preference for the *lex personalis* of a legal person, particularly the law of its main place of business, while the latter stresses the importance of the law of the place of commission of the conducts. According to the drafters of the Model PIL, the main reason for this difference is to prevent foreign legal persons, who enjoy full capacity for civil conducts under its *lex personalis*, from evading Chinese law when they engage in commercial activities in China.²⁷

Aside from the above LAL provision, Chinese law also contains rules exclusively **42** applicable to foreign legal persons. Art. 184 of the Opinions on GPCL provides that the capacity for civil conducts of a foreign legal person is determined according to the law of its place of incorporation (*lex patriae*). Besides, a foreign legal person engaging in civil conducts in China must comply with Chinese law. Therefore, it seems that both its *lex patriae* and Chinese law govern a foreign legal person's capacity for civil conducts. On this point, this provision shares the same position of the Model PIL provision mentioned above.

²⁷ Chinese Society of Private International Law, 123.

IV. State and International Organizations

- 43 Generally, private international law governs civil and commercial relations between equal parties: mostly natural persons and legal persons. Since states and international organizations are generally considered typical actors of public international law and are not necessarily subject to foreign state law, their legal personalities and conducts are often not governed by private international law. However, states and international organizations may engage in commercial activities with private persons. Due to the public nature of states and international organizations, it would be unrealistic to equate them with private persons, even if they deal with commercial contracts.
- 44 As far as states are concerned, sovereign immunity is generally deemed as a fundamental right of states under international law. If a dispute between a state and a private person arises out of their commercial transactions, the state may argue that a foreign court or international arbitral tribunal cannot adjudicate on the dispute unless the state decides so, because it enjoys jurisdictional immunity. Even if the state is deemed to have waived its jurisdictional immunity by concluding commercial contracts or arbitration agreements with a private party, it may still claim immunity from execution, which, if granted, will bar the execution of any judgments or arbitral awards.
- 45 In brief, state immunity is derived from the rule *par in parem non habet imperium* and is rooted in the principles of independence, equality and dignity of states, and international comities.²⁸ State immunity may roughly be divided into restrictive immunity and absolute immunity. The first clear statement on the doctrine of absolute immunity can be found in British and US-American case law in connection with foreign public ships, and in French case law in connection with contracts and debts of foreign states.²⁹ This doctrine was later recognized in other jurisdictions, evolving either independently or under the influence of British and US-American precedents, for quite a long period before restrictive immunity was accepted.³⁰
- 46 According to the doctrine of restrictive immunity, immunity only applies to states when they are involved in public law acts (*acta jure imperii*) and not when they

²⁸ OPPENHEIM/LAUTERPACHT, 239; FOX, 28-31.

²⁹ BADR, 34.

³⁰ BADR, 39.

engage in private law acts (*acta jure gestionis*). The rationales are twofold: on the one hand, when a state enters into a commercial transaction with a private party, it is expected to honor its commitments under the transaction in the same way as its private counterpart; on the other hand, it is also beneficial for the state to comply with the obligations of the transaction, because otherwise it may lose credibility and dignity.³¹ Restrictive immunity received prevailing acceptance internationally, particularly after World War II.³² Nowadays, restrictive immunity is believed to have acquired “the status of a principle or rule as one of international custom”³³.

Concerning international organizations, they are often established for specific 47 purposes in accordance with their charters. In order to effectively carry out their functions, these organizations may engage in commercial activities with private persons. Thus, they are granted a legal personality and can enjoy immunities, other rights, and bear obligations accordingly. For instance, according to art. 1 of the 1946 Convention on the Privileges and Immunities of the United Nations, the UN has a legal personality and has the capacity to contract, acquire, and dispose of immovable and movable property as well as to initiate legal proceedings. Similar to states, international organizations are also typical actors of public international law, although a notable difference exists. Due to their public nature, international organizations are generally not governed by the private international law of a certain state, and accordingly, state laws seldom prescribe any provisions in this regard.³⁴

China’s general attitude towards state immunity seems old-fashioned, if not ill- 48 perceived. In fact, China is believed to have been one of the staunchest practitioners of the doctrine of absolute immunity until it signed the UN Convention on Jurisdictional Immunities of States and Their Property in 2005.³⁵ Specifically, unlike many states, China does not have a uniform state immunity law. Chinese courts seldom handle cases involving foreign state immunity issues.

Recently, *FG Hemisphere Associates, LLC v Democratic Republic of Congo*, which 49 was handled by Hong Kong SAR courts brought up this issue.³⁶ In this case, a

³¹ See *SORNARAJAH*, 664-665.

³² See, e.g. *LAUTERPACHT*, 226 et seq.; *TROBOFF*, 266; *SINCLAIR*, 196; *VIBHUTE*, 47 et seq.; *HAFINER/KÖHLER*, 5.

³³ *FOX*, 22.

³⁴ *YU Fei*, 313.

³⁵ *Qi Dahai*, 307, 316, 320.

³⁶ For details, refer to *CARTY/JONES*, 43-50.

private company, FG Hemisphere Associates LLC, sought to enforce an ICC arbitral award against the state of Congo in the SAR courts. One of the issues that the courts were requested to decide on was whether Congo, as a sovereign state, should be granted immunity, meaning that the award would not be executed. Though there is no compelling need to elaborate on this case, it is helpful to note that the judges in this case referred to several documents which seemed to suggest that China still clings to the doctrine of absolute immunity for states.³⁷

V. Legal Status of Foreigners in China

- 50 Though a state generally has the sovereign power to decide the legal status of foreigners, it must follow international law when making such decisions. In general, national treatment and most-favored nation treatment are among the most common types of legal status granted to foreigners in modern times. In practice, both types of treatments are often granted to foreigners in accordance with international treaties and tend to exist on a reciprocal basis.
- 51 When dealing with foreign-related civil and commercial relations, in general, Chinese law is equally applicable to both Chinese nationals and foreigners, however, subject to certain exceptions. Thus, in practice, foreigners are granted national treatment in China. Such a stance is supported by art. 8 (2) GPCL, which provides that *“the provisions relating to citizens contained in this law shall be applied to foreigners and stateless persons in Chinese territory, unless otherwise provided”*. Many international treaties to which China is a party also confirm the national treatment of foreigners under Chinese law. For instance, relevant WTO agreements³⁸ and almost all Sino-foreign Bilateral Investment Treaties (BITs) confer it.³⁹
- 52 The Model PIL clearly puts forward the term national treatment. According to art. 3(1), except otherwise provided by Chinese law, the legal rights and benefits of a foreign person who engages in civil and commercial conducts in Chinese territory

³⁷ *Democratic Republic of Congo et al v FG Hemisphere Associates LLC*, arbitration award dated at para. 464.

³⁸ See, e.g. Art. 17, General Agreement on Trade in Services; Art. 3, Agreement on Trade-Related Aspects of Intellectual Property Rights; Art. 2, Agreement on Trade-Related Investment Measures.

³⁹ A list of Sino-Foreign Bilateral Investment Treaties is provided by the Department of Treaty and Law, Ministry of Commerce, available at <http://tfs.mofcom.gov.cn/aarticle/Nocategory/201111/20111107819474.html>.

are granted national treatment. Furthermore, art. 3 (1) also clarifies that such national treatment is only applied on a reciprocal basis. Besides, China is also supportive of the most-favored nation treatment, although no domestic law rules clearly contain such a clause. China's position can be found in many international treaties, particularly the BITs and WTO agreements mentioned above.⁴⁰

Despite China's granting of national treatment and most-favored nation treatment to **53** foreigners, such treatments only cover a limited aspect of legal rights and benefits. According to Chinese law, such rights include the right to succession, labor rights, intellectual property rights, the right to conduct business, and judicial protection.⁴¹

⁴⁰ See, e.g. Art. 2, General Agreement on Trade in Services; Art. 4, Agreement on Trade-Related Aspects of Intellectual Property Rights.

⁴¹ See, *Yu Fei*, 322-324.

Chapter 20. Family, Marriage, and Succession

Literature: WAN E'xiang (ed.) (万鄂湘编著), Understanding and Applying the Law of the Application of Law for Foreign-related Civil Relations (涉外民事关系法律适用法条文理解与适用), Beijing 2011. WANG Liming (王利明), Civil Law (民法), Beijing 2005. Yu Fei (于飞), Theory and Legislation of Chinese Private International Law (中国国际私法理论与立法), Beijing 2004. ZHANG Bozhong (张伯仲), Private International Law (国际私法), Beijing 2010.

I. Marriage

- 1 China's major legal instruments governing marriage include, *inter alia*, the Marriage Law (ML)¹, the relevant provisions of the GPCL, the Regulation on Marriage Registration², and relevant SPC judicial interpretations. Although Chinese law does not provide a clear definition of the term marriage, a marriage generally means a male and a female, who after completing certain formalities, are recognized as husband and wife by law. Although there is no express *de jure* prohibition, unlike some other countries, China does not recognize homosexual marriage to date. This ban is implied by art. 5 ML, which provides that marriage is based on the willingness of "a man and a woman".
- 2 Legal requirements on marriage are generally divided into substantive and formal requirements, which are subject to different rules on conflict of laws. Although Chinese law traditionally does not draw a clear distinction between substantive and formal requirements, recent laws highlight such a distinction.

1. Substantive Requirements

- 3 According to the ML, substantive requirements for marriage are either positive (affirmative) or negative (prohibitive). Art. 5 ML provides that marriage must be based on free will. Considering China's long history of "arranged marriages" or "blind marriages", this provision especially requires that marriage is free from coercion, fraudulence, and third party intervention. Art. 6 ML further requires a minimum age

¹ 婚姻法, promulgated on 10th September, 1980 and effective from 1st January, 1981; last revision effective from 28th April, 2001.

² 婚姻登记条例, promulgated on 30th July, 2003 and effective from 1st October, 2003.

to marry, namely, 22 for males and 20 for females. Besides, art. 7 ML also provides two situations where marriage is prohibited: (1) when a couple is lineal relatives by blood or collateral relatives by blood up to the third degree of kinship, or (2) certain diseases exist.

The LAL deals with foreign-related marriage issues in several provisions. ⁴ Concerning the substantive requirements, according to art. 21 LAL, the applicable law is the law of the place where both parties have their common habitual residences; absent such a residence, the law of their common nationality will be applied; absent such nationality, and if the marriage is concluded in the place where one of the parties has his/her habitual residence or nationality, the law of the place where the marriage is registered will be applied.

From a historical perspective, art. 21 LAL is deemed to represent a progress ML.³ ⁵ Before the adoption of the LAL, art. 147 GPCL provides that the law applicable to marriage between a Chinese national and a foreigner is the law of the place where the marriage is registered. This provision is criticized for its rigidity and incompleteness as it fails to take into account the various types of foreign-related marriages. For instance, it is easy to evade such a provision by choosing a different registration place (migratory marriage).⁴ Unlike this traditional method, art. 21 LAL adopts the “mixed mode” by stressing the law of the parties’ residence, the nationalities of the parties, while abandoning the sole reliance on the place of registration.

Despite such improvements, the LAL provision still fails to consider certain ⁶ situations. For instance, one such situation is for a Chinese court to decide the validity of a marriage between two foreigners. According to art. 21 LAL, if both parties are foreigners, the applicable law to their marriage should be decided in the following way: (1) the law of their common habitual residence will be applied; (2) if they do not share a common habitual residence, then the law of their common nationality will be applied; (3) if they do not share a common nationality, but one of them has habitual residence in China, then Chinese law will be applied; however, if neither of them has habitual residence in China, the LAL provision will not provide any guidance. According to SPC judges, in such an extreme situation, Chinese law

³ WAN E'xiang, 159.

⁴ See YU Fei, 480.

should be applied, pursuant to art. 2 LAL (the closest connection principle), because in such cases, Chinese law should bear the closest connection with their marriage.⁵

2. Formal Requirements

- 7 As far as formal requirements are concerned, art. 8 LAL provides that a marriage must be registered with the competent authorities, which is the local Bureau for Civil Affairs. Furthermore, according to art. 4 of the Regulation for Marriage Registration, if a Chinese citizen marries a foreigner in China, they will have to register in a registration office of the place where the Chinese citizen has his/her “*huji*” (*supra* Chapter 19 at 8). Citizens of the Hong Kong SAR, the Macao SAR and Taiwan are deemed as foreigners. Such registration requirements also apply to foreigners who marry in China.
- 8 Although formal requirements for marriage are necessary, it does not necessarily mean that a marriage missing such requirements would be deemed invalid under Chinese law. This is confirmed by art. 11 ML, which does not expressly list failure to fulfil the formal requirements as a ground to nullify a marriage. Rather, art. 8 provides the parties a chance to cure the flaw, i.e. the parties are required to go through the registration procedures subsequently.
- 9 According to art. 22 LAL, if the formal requirements of one of these laws are satisfied, then the marriage will be recognized as valid under Chinese law: the law of the place of registration, the law of the habitual residence, or the national law of one of the parties. Clearly, Chinese law adopts the “mixed mode” and provides at least three types of applicable laws by which to decide the validity of a marriage. Yet, Chinese law is silent as to the order of applying these different laws. Despite this silence, Chinese law does not allow parties to choose one of these laws, since art. 3 LAL provides that the parties may choose an applicable law where the law explicitly allows so. Consequently, the applicable law should be decided solely at the court’s discretion.

⁵ *WAN E’xiang*, 161.

II. Matrimonial Relations

Under Chinese law, matrimonial relations, namely, the relations between a husband and a wife can be divided roughly into personal relations and property relations, which will be analyzed. 10

1. Matrimonial Personal Regime

Matrimonial personal relations cover a broad range of issues. In fact, all of these 11 issues reflect certain aspects of Chinese culture and social backgrounds, and thus must be understood within the context of China. Art. 14 ML provides for the right to name, meaning that both a husband and wife may use his or her own name after marriage. This is different from some other countries where the wife adopts the husband's surname after marriage. Art. 9 ML provides for the right to domicile, meaning that a husband and wife have equal rights to decide, by agreement, their domicile after marriage. Taking the social customs of many parts of China into account, this provision provides a chance for the couple to live independently. Art. 15 ML provides for the right to work, meaning that a husband and wife have the right to work, study, and engage in other social activities. This provision is an important guarantee for females so that they will not necessarily become full-time housewives after marriage.

In addition to these provisions, there are also certain types of personal relations that 12 are implied in the law. For instance, different from the marriage laws of many other countries, Chinese marriage law does not contain an express provision regarding the obligations of marital faith and cohabitation. However, such obligations are implied by other provisions. According to art. 32 ML, violation of these obligations may well constitute a legal ground for divorce (*infra* at 23).

In foreign-related marriages, the law of the couple's common habitual residence 13 governs matrimonial personal relations; absent such a residence, their common national law is applied. The fundamental reason as to why the law of habitual residence takes priority over national law is that, the former often bears closer connection with the real life of the couple. This is particularly true considering that many people do not live in their national states. According to art. 2 LAL, in cases

where no common habitual residence or nationality exists between the couple, the closest connection rule comes into play.

2. Matrimonial Property Regime

- 14** Property relations are another category of matrimonial relations, which cover a wide range of issues relating to, *inter alia*, ownership, and the right to disposal and the settlement of debts. With regard to matrimonial property relations, similar to many state laws, Chinese law recognizes both consensual and statutory property relations.
- 15** According to art. 19 ML, a husband and wife may reach a written agreement regarding the ownership of properties acquired during or before their marriage. They may agree that such properties are owned by either one of them, jointly, or partially jointly. Such an agreement is binding on both parties. In cases where there is no such agreement, which is often seen in practice, or such agreement is not sufficiently explicit, arts. 17 and 18 ML come into play and provide the statutory property relations.
- 16** According to art. 17 ML, absent an agreement, the following items or properties acquired by either the husband or wife during their marriage are owned jointly: (1) salaries or bonuses; (2) earnings of their work; (3) earnings derived from intellectual property rights; (4) property inherited or donated property, except as provided in art. 18 (3); and (5) other jointly possessed properties. Besides, both parties have equal rights in disposing of their jointly owned properties. Art. 18 ML lists several items or properties that are under the ownership of only one of the parties, such as (1) pre-marital property owned by only one party, (2) subsidized payments for medical treatment or living subsidies for the physically disabled party, (3) property that is designated exclusively to a party by testament or a donation agreement, (4) articles for personal use by a party, and (5) other property possessed by only one party.
- 17** With respect to a foreign-related marriage, its property and matrimonial personal relations are subject to different rules on conflict of laws. As to matrimonial property relations, art. 24 LAL recognizes restrictive party autonomy. It provides that the parties may agree to choose to apply any of these laws: the law of a party's habitual residence, the national law of a party or the law of the place where the major part of their property is located. Absent such a choice, the law of the parties' common

habitual residence will be applied; absent such a residence, the common national law of the parties will be applied.

III. Divorce

Under Chinese law, divorce may be achieved in two ways, namely, divorce by **18** agreement or divorce by litigation.

1. Divorce by Agreement

According to art. 31 ML, in cases where a husband and wife apply for a divorce by **19** agreement, such an application should be allowed if they can reach an agreement on the disposal of their property and children, if necessary. Besides, according to art. 10 of the Regulation for Marriage Registration, this rule also applies to marriages between citizens of Mainland China and citizens of Taiwan, the Hong Kong SAR and Macao SAR.

As to foreign-related divorces, according to art. 26 LAL, in cases of a divorce by **20** agreement, parties may choose to apply the law of the habitual residence or the national law of either party. Furthermore, if the parties fail to reach an agreement on the choice of law, then the law of their common habitual residence will be applied; absent such a residence, their common national law will be applied; absent such nationality, the law of the place where the authority charged with the divorce procedures is located will be applied.

It should be noted that the law chosen by the parties will be applicable only to the **21** substantive issues of divorce, such as the conditions for divorce, the allocation of property, and the maintenance of the spouse and children, if applicable. Such autonomy does not extend to procedural issues, because such issues are generally deemed as “public law acts” and are governed by the law of the state in which the divorce procedure is handled. Besides, it must also be mentioned that, despite the recognition of party autonomy, the law chosen by the parties must not go against public policy of China, as decided by the courts on a case-by-case basis. This is also reflected in art. 5 LAL, which provides that, in general, in cases where the application of a foreign law violates the social public interests of China, Chinese law will apply.

2. Divorce by Litigation

- 22** In sharp contrast to divorce by agreement, in cases of divorce by litigation, the applicable law is the law of the place where the court is seated (*lex fori*). This provision is applied to various aspects of foreign-related divorce, such as personal relations between the parties, the division of property, the damages of divorce, and the maintenance of children, depending on the specific case. For public policy reasons, this provision excludes the possibility to apply foreign law. However, this provision only deals with the situation where a divorce is between a Chinese citizen and a foreigner and fails to deal with situations where two foreigners apply for divorce in China or two Chinese citizens apply for divorce in a foreign court.
- 23** Concerning the conditions for divorce, art. 32 ML provides several situations where an application for divorce by litigation should be granted: (1) a party committed bigamy; (2) a party cohabitates with a third party; (3) a party committed family violence, maltreatment, or deserted the family members; (4) a party is addicted to drugs or gambling; (5) the parties have been separated for over two years due to emotional incompatibility; and (6) other circumstances that cause alienation of the affection between a husband and wife.
- 24** With regard to jurisdictional issues in foreign-related divorce by litigation, Chinese law does not contain specific rules. Yet, the general jurisdictional rules contained in the CPL should be applied.⁶ According to art. 22 CPL, foreign-related divorce cases should be handled by the court of the defendant's domicile. In cases where the defendant's domicile is different from his habitual residence, the court of his habitual residence has jurisdiction. On the other hand, according to art. 23 CPL, it is also possible for the court of the plaintiff's domicile or habitual residence to exercise jurisdiction. Art. 23 (1) CPL provides that if the defendant does not reside in China, the court of the plaintiff's domicile will have jurisdiction over cases of personal relations. If the plaintiff's domicile is different from his habitual residence, the court of the latter place will have jurisdiction. Given these two provisions, it seems that Chinese courts may have jurisdiction over all types of foreign-related divorce cases.
- 25** Finally, it is also worth mentioning that Chinese law also contains provisions regarding divorce damages. According to art. 46 ML, in the following situations the

⁶ WAN E'xiang, 201.

innocent party is allowed to claim divorce damages if the guilty party committed one of the following: bigamy, cohabitation with a third person, family violence, and/or maltreating or desertion of any family member. Pursuant to art. 28 of the First Interpretation of the SPC on Certain Issues in the Application of ML of the PRC⁷, such damages include compensation for both physical and mental damage. With regard to the applicable law issues in connection with divorce damages, art. 23 LAL applies.⁸

IV. Family Relations

It is often too hard to precisely define the term “family” due to cultural reasons. This 26 book takes a broad meaning of this term, covering aspects such as parent-child relations, maintenance, adoption, and guardianship. Relevant provisions governing these aspects are scattered over different laws, SPC judicial interpretations, and international treaties.

In China, many laws and their respective implementing rules (often in the form of 27 SPC judicial interpretations) provide rules on conflict of laws to settle foreign-related family relations issues, such as the ML, the Succession Law⁹, the Adoption Law¹⁰, and the Law on the Protection of Minors¹¹. Some Sino-foreign consular agreements also contain provisions dealing with various aspects of family relations.¹²

1. Parent-Child Relations

Under current Chinese law, parent-child relations may be roughly categorized into 28 two types: relations based on the birth of a child and relations based on the adoption of a child. To date, Chinese law is silent regarding parent-child relations based on the artificial bearing of a child. In general, parent-child relations cover various

7 最高人民法院关于适用《婚姻法》若干问题的解释(一), promulgated on 24th December, 2001 and effective from 27th December, 2001.
8 WAN E'xiang, 185-186.
9 继承法, promulgated on 10th April, 1985 and effective from 1st October, 1985.
10 收养法, promulgated on 29th December, 1991 and effective from 1st April, 1992; last revision effective from 1st April, 1999.
11 未成年人保护法, promulgated on 4th September, 1991 and effective from 1st January, 1992; last revision effective from 1st June, 2007.
12 A list of Sino-Foreign consular treaties is available in the official website of the Ministry of Foreign Affairs, available at <http://cs.mfa.gov.cn/zlfg/bgzl/wjjg/P020110627365800699216.pdf>.

aspects, including property and personal relations, which often involve various branches of the law.

29 Historically, before the adoption of the LAL, Chinese law contained no express provisions with regards to the applicable law of foreign-related parent-child relations. Art. 148 GPCL only provides that the applicable law of the parent and his/her dependent children is decided on by the closest connection principle. Art. 25 LAL elaborates on this vagueness. It provides that parent-child personal and property relations are determined by the law of their common habitual residence. In cases where no such residence exists, the applicable law is that of the habitual residence or the national law of one of the parties, whichever is more favorable to the weaker party. It is worth mentioning that the latter half of this provision aims to protect the weaker party in parent-child relations. As is suggested, such a provision is specially designed for the protection of minors and the elderly.¹³

2. Adoption

30 In recent years, cross-border adoption has become increasingly popular in China. Despite the fragmentation of state laws in this regard, it is generally required that a valid adoption must conform to both substantive and formal requirements.

31 In China, the Adoption Law is the core legal instrument governing foreign-related adoption. In order to help implement this law, the Ministry of Civil Affairs, upon approval of the State Council, promulgated the Registration Rules on Adoption by Foreigners in the PRC¹⁴. It provides detailed procedural rules for foreign-related adoption in China. At the international level, China is a party to the Convention on Protection of Children and Cooperation in Respect of Inter-country Adoption (Convention of Adoption).¹⁵ Thus the relevant provisions of this Convention are also binding in China. In cases where Chinese domestic law and the Convention of Adoption contain conflicting provisions, the latter prevails in accordance with art. 142 GPCL (*supra* at Chapter 18 at 19).

¹³ WAN E'xiang, 189.

¹⁴ 外国人在中华人民共和国收养子女登记管理办法, promulgated on and effective from 25th May, 1999.

¹⁵ Decision of the Standing Committee of the National People's Congress on Ratifying the Convention on the Protection of Children and Cooperation in Respect of Inter-Country Adoption (跨国收养方面保护儿童及合作公约), promulgated on 29th May, 1993 and effective in the PRC from 27th April, 2005.

In essence, Chapter 2 of the Adoption Law provides concrete substantive and formal requirements for adoption. It should be noted that art. 21 of the Adoption Law clearly provides that foreigners may adopt Chinese children, for which it sets forth certain requirements. It is thus reasonable to conclude that foreign-related adoption is governed by art. 21 (*lex specialis*). For issues not dealt with by this provision, other provisions of the Adoption Law shall apply. **32**

Art. 21 of the Adoption Law provides concrete procedural requirements for foreigners to adopt children in China. According to this provision, a foreigner must obtain approval from the competent authorities of his or her national state in accordance with the law of that state. The adopter must suffice certificates regarding his age, matrimonial status, health conditions, profession, and other relevant information. Adoption must be completed by means of an adoption agreement and must be registered with Chinese civil affairs authority at the provincial level. However, this provision is defective in two aspects: (1) it only deals with the situation where foreigners adopt children in China, (2) it is silent as to the law governing foreign-related adoptions. **33**

Historically, Chinese law did not contain any express rules on the law of foreign-related adoption before the LAL. Thus the closest connection principle, codified in art. 148 GPCL, dealt with maintenance and is applied in general. Art. 138 of the Model PIL governed foreign-related adoption in three aspects: (1) regarding the establishment of an adoption, the law of the domicile or habitual residence of both the adopter and adoptee; (2) regarding the legal effects of an adoption, the law of the domicile or habitual residence of the adopter when the adoption is completed; (3) regarding the termination of an adoption, the law of the domicile or habitual residence of the adoptee or the law of the place where the court is seated (*lex fori*). **34**

The above position was finally codified in the LAL after slight revision. According to art. 28 LAL, foreign-related adoption is also divided into three aspects, each subject covered by a different law. The qualifications for and formalities of an adoption are governed by both the laws of the adopter and adoptee's habitual residence; the effect of an adoption is governed by the law of the adopter's habitual residence at the time of the adoption; and the termination of an adoption is governed either by the law of the adoptee's habitual residence at the time of adoption or by the *lex fori*. **35**

3. Maintenance

- 36** Chinese law does not contain a unified and clear definition of maintenance. Such a definition is provided in various different laws dealing with different types of civil relations. For instance, art. 20 ML provides a workable definition of maintenance between spouses. Similarly, Chapter 2 of the Law of Protection of the Rights and Interests of the Elderly¹⁶ deals with family maintenance of the elderly. For the purpose of this book, suffice is to say that maintenance is a statutory obligation among family members which cannot be derogated by agreements. In practice, maintenance often occurs between spouses, parent and child, and other family members.
- 37** Formerly, art. 148 GPCL provided that the law of the state with which the maintenance bears the closest connection would be the law applicable to maintenance. The purpose was to offer protection to the weaker party in a maintenance relation. Art. 189 of the Opinions on GPCL provides more workable rules. It provides that maintenance should be interpreted in a broader sense to cover that between spouse, parent and child, and other family members. It also recognizes the closest connection principle in dealing with foreign-related maintenance relations. To clarify the closest connection principle, this provision lists three options: the national laws or the laws of the domiciles of the creditor and debtor of the maintenance and the place where the asset used for maintenance is located.
- 38** Art. 29 LAL, while absorbing the merits of the above stated provision, takes a different approach. According to this provision, maintenance is governed by the law of one party's habitual residence or nationality, or by the law of the place where the main asset is situated, whichever is more favorable to the protection of the rights and interests of the maintenance creditor. Although this provision does not provide a clear definition of maintenance, a broad interpretation is implied.¹⁷ Compared with the above provision, a notable change of this LAL provision is that it does not use the term "the property used for maintenance" in order to avoid a possible debate on the nature and identification of such property.

¹⁶ 老年人权益保障法, promulgated on 29th August, 1996 and effective from 1st October, 1996; last revision effective from 27th August, 2009.

¹⁷ *WAN E'xiang*, 216.

This LAL provision also highlights the necessity and legislative intention to protect the weaker party in a maintenance relation by invoking the “more favorable” standard in deciding the applicable law. Despite all its merits, in practice, this standard may invite difficulty because it could be difficult for the court to decide which law should be deemed as “more favorable”. Obviously, there is no fixed answer to this question. Yet, it is proposed that courts should adopt the so-called “policy orientation method” to examine not only the connecting factors needed to decide the applicable substantive law, but more importantly, they must also examine the contents of all possible applicable substantive laws in order to decide which law offers a higher level of protection to the weaker party. 39

4. Guardianship

Guardianship generally refers to a civil legal system of supervising and protecting personal, property and other legal rights and interests of minors and mentally disabled persons or any other persons with limited civil capacity.¹⁸ Chinese law has a broad understanding of guardianship. The main rules regarding guardianship are provided in Section 2 (Guardianship) of Chapter 2 (Natural Persons) of the GPCL. 40

With regards to persons qualified to be guardians, according to arts. 16 and 17 GPCL, Chinese law provides for a wide range of such persons. Art. 16 provides that guardians for minors may be their parents, grandparents, elder siblings, and other family members or friends upon the approval of the competent authorities. Art. 17 GPCL provides that guardians for mentally disabled persons may be their spouse, parents, adult children, other close relatives, and other close family members or friends upon the approval of the competent authorities. Concerning the obligation of guardianship, art. 18 GPCL provides that the guardians must protect the personal, property and other legal rights and interests of the ward, and are not allowed to dispose of the property of their wards unless it is in the latter’s interests. 41

Besides, with special respect to the protection of minors, rules may also be found in the Minor Protection Law. For instance, Chapter 2 of this law clearly imposes various types of obligations on guardians to protect minors, while art. 53 and 62 provide civil penalties for guardians who fail to fulfil their guardian obligations. 42

¹⁸ WANG Liming, 57.

- 43** Regarding the applicable law of guardianship, formerly, art. 190 of the Opinions on GPCL provides that the establishment, modification, and termination of maintenance are governed by the *lex personalis* of the ward, which includes both the national law of the ward (*lex patriae*) and the law of his domicile (*lex domicilii*). This provision was modified by art. 30 LAL. According to art. 30 LAL, guardianship is governed by the law of the habitual residence or nationality of one of the parties (either the guardian or the ward), whichever is more favorable to the protection of the rights and interests of the ward. Compared to art. 190 of the Opinions on GPCL, art. 30 LAL seems less strict, but is more favorable of the protection of the weaker party in guardianship relations.
- 44** In applying art. 30 LAL, a practical question would be how to decide whether a certain law is “more favorable” to the ward. It is suggested that, since the level of protection of the ward depends substantially on the capability of his guardian, the court needs to compare which law affords the guardian a more favorable treatment. It seems implied that the so-called “policy orientation method” should be employed for such comparison. In this connection, though Chinese law has no express provision, the Opinions on GPCL provides some guidance. According to art. 11, the guardian’s capability should be assessed according to his health conditions, economic situation as well as the closeness of his relationship with the ward.

V. Succession

- 45** Under Chinese law, succession can generally be divided into intestate succession and testate succession. Art. 5 of the Succession Law (SL) clearly recognizes both types of successions, and further clarifies them in Chapter 2 and Chapter 3, respectively. Art. 36 deals exclusively with foreign-related succession.

1. Intestate Succession

- 46** Under Chinese law, intestate succession is deemed as the default mode of succession, unless the decedent has made a will. Concerning intestate succession, several major issues are pertinent: qualified heirs and their respective order as well as their share of the estates.
- 47** Generally, the order of succession of qualified heirs and their share of the estates are determined by the closeness of their relations with the decedents. Some state

laws provide for a broad range of heirs, while others only treat a small group of persons as qualified heirs. Under Chinese law, qualified heirs and their order of succession are dealt with by art. 10 SL. According to this provision, the estates of the decedents are inherited in the following order: heirs of the first order of succession (spouse, children, and parents); then heirs of the second order of succession (siblings and grandparents). The existence of heirs of the first order excludes the statutory inheritance rights of heirs of the second order. Besides, according to art. 9 SL, males and females are equal in succession. Considering China's family tradition of male preference, this clause is deemed as an important guarantee for gender equality.

It should be noted that the SL also provides two exceptional situations where 48 persons other than the heirs identified in art. 10 may inherit certain shares of the estates. According to art. 14, in addition to the heirs, an appropriate share of estates may also be given to a person who is dependent on the decedent and has no work or source of income, or to one who has undertaken comparatively more work in supporting the decedent.

Interestingly, unlike some state laws, Chinese law does not provide any express rule 49 regarding the share of estates among qualified heirs. Art. 15 SL provides that the heirs should negotiate the time, method and shares of the estates. In cases where no agreement is reached, the heirs may apply for conciliation to the People's Conciliation Committee or initiate a lawsuit in the competent court.

With regards to the law applicable to foreign-related intestate succession, similar to 50 some state laws, Chinese law adopts the "distinctive approach", i.e. to apply different laws to real estates and movable estates. According to art. 36 SL, the law of the decedent's domicile governs the inheritance of movable estates in various situations of succession, while the law of the place where such an estate is located (*lex loci rei sitae*) governs the inheritance of real estates. This position is confirmed by art. 149 GPCL, which is almost identical to art. 36 SL.

The LAL substantively echoes the above position with a slight change. Art. 31 LAL 51 provides that intestate succession is governed by the law of the place where the decedent's habitual residence is located, but inheritance of real estates is governed by the *lex loci rei sitae*. Besides, such an applicable law governs various aspects of

intestate succession, including, *inter alia*, commencement of succession, identification of qualified heirs, the estates to be inherited, and the share of the inherited estates.¹⁹

2. Testate Succession

- 52** Testate succession is another major type of succession under Chinese law. A testament disposes of the decedent's estates and becomes effective upon his/her death. Chinese law provides a series of rules on conflict of laws to deal with both the formal and substantive aspects of testate succession.
- 53** Regarding the form of testate succession, Chinese law allows a testament to take several different forms. According to art. 17 SL, a testament may be notarized or self-written. It may also be written by others or recorded with the decedent's signature; if needed, it may also be made in oral form. Art. 31 LAL deals with the form of testament and provides the law applicable to decide whether a testament is formally established. According to this provision, a testament will be valid if its form satisfies the requirements under any of these laws: (1) the law of the decedent's habitual residence when his testament is made or when he dies, (2) the decedent's national law, or (3) the law of the place of testate.²⁰
- 54** The substantive aspects of a testament, which cover mainly the capacity of a testator, and the legal effects and contents of the testament, are dealt with by different laws in China. First, Chinese law recognizes that a citizen's capacity to testate is a form of his civil capacity. Thus, although the SL as *lex specialis* is silent on this issue, the GPCL provisions regarding a citizen's civil capacity for conducts apply. In other words, if a citizen is deemed to have full civil capacity for conducts, he has the capacity to testate. In this regard, art. 16 SL provides that the testator may dispose of his estates freely, including designating his heirs and estates executer. Furthermore, art. 22 LAL clarifies this position, however, from a negative perspective, providing that testaments made by citizens who do not possess full capacity for conduct are invalid.
- 55** Second, regarding the contents of a testament when dealing mainly with qualified heirs and their shares of the inherited estates, testators may exercise varied

¹⁹ WAN E'xiang, 235.

²⁰ WAN E'xiang, 246.

degrees of discretion under different state laws. In this regard, Chinese law generally recognizes citizens' testamentary freedom, allowing testators to dispose of their estates at their own discretion, subject to a few exceptions. According to art. 22 SL, if a testament is made by a citizen with or without limited civil capacity, or under coercion or fraudulence, or is faked or falsified, it will be deemed as invalid. Besides, although not expressly provided, it is implied that a testament conflicting with social and public policy is recognized as invalid.

3. Management of Estates

The management of estates is of practical importance as it is highly relevant to the 56 rights and interests of the heirs and the decedent's creditors. It is relevant in both statutory and testate succession and covers a broad scope of conducts and necessitates both rights and obligations, such as identifying estate executor, collecting credits, and settling a decedent's debts.

Strictly speaking, China has not established a sound legal system of estates 57 management.²¹ The SL contains some provisions dealing with the management of estates, which may be applied to both foreign-related and domestic successions. In brief, art. 24 SL provides that anyone who possesses the estate of the decedent shall carefully maintain it and that no one is to misappropriate or contend for it. Further, art. 29 SL provides that the allocation of the estates should be conducive to production and livelihood (of the heirs). Art. 33 SL provides that the applicable tax or debts of the decedent should be satisfied prior to the allocation of the estates.

According to art. 34 LAL, on the law applicable to the management of estates in 58 foreign-related succession, the governing law should be that of the place where such estates are located. Here, Chinese law does not distinguish real estates and movable estates. Besides, it should be noted that some Sino-foreign consular treaties also contain provisions on the management of estates, such as the Consular Treaty between the People's Republic of China and the Republic of Mongolia.²² In such cases, according to art. 142 GPCL (*supra* at Chapter 18 at 19), treaty provisions prevail over the SL.

²¹ WAN E'xiang, 255.

²² See ZHANG Bozhong, 438-439.

4. Succession of Heirless Estates

- 59 In reality, it is possible that no heirs can be identified to inherit the decedent's estates. A typical reason could be that the decedent has no statutory heirs and makes no testament to dispose of his estates, or that all heirs lose their rights to succession. It is thus necessary to first discuss how to identify whether certain estates should be deemed as heirless estates and follow up with who should inherit such heirless estates.
- 60 Concerning the first issue, it is widely accepted that the applicable law of succession should be applied to decide whether certain estates are to be deemed as heirless estates. In practice, such a law could refer to either the national law of the decedent (the law of his nationality or domicile) or the *lex loci rei sitae*. On this issue, Chinese law does not contain an express provision. Therefore, the general rule on conflict of laws governing foreign-related succession, namely art. 149 GPCL, applies. Under this provision, when the decedent dies, the law of his domicile should govern whether his movable estates are heirless estates, while the *lex loci rei sitae* should govern whether his real estates are heirless estates.
- 61 Concerning the second issue, art. 35 LAL provides that the applicable law should be that of the place where the decedent's estates are located when he dies. It should be noted that this provision does not distinguish real estates and movable estates; thus, it should be applied to both types of estates. In cases where this rule refers to the substantive law of China, the SL comes into play. With regard to heirless estates, art. 32 SL provides that heirless estates are generally inherited by the state of China. Such a provision is different from many state laws and reflects China's long-rooted orientation towards the state's interests in lawmaking. Furthermore, as mentioned earlier, some Sino-foreign consular treaties also deal with succession issues. Therefore, according to art. 142 GPCL, if these relevant treaties contain different rules, such rules shall prevail (*supra* at Chapter 18 at 19).

Chapter 21. Property Rights, Obligations and Intellectual Property Rights

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I. Introduction

This Chapter deals with several types of civil relations that probably carry the most 1 practical significance in people’s daily life. It touches upon various fields of law, such as property law, contract law, intellectual property law, and tort law. As mentioned in previous chapters, in China, property rights (real rights) and obligations are governed principally by the Real Rights Law (RRL)¹, the Contract Law, and the Law on Tort Liability². The main sources of intellectual property (IP) rights include the

1 物权法, promulgated on 16th March, 2007 and effective from 1st October, 2007.

2 侵权责任法, promulgated on 26th December, 2009 and effective from 1st July, 2010.

Patent Law³, the Copyright Law⁴, and the Trademark Law⁵. Most of these laws are either newly adopted or recently amended in order to keep pace with the country's rapid economic development in recent decades. In addition to these laws, there are also a large number of relevant SPC judicial interpretations and administrative regulations. China is also a contracting state to various international conventions in the above areas, such as the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG).

- 2 It should be noted that, although the laws of contract, tort, property rights, and IP rights are quite numerous and fragmented, the importance of the rules on conflict of laws in these fields has been somehow diluted in recent years. One reason is the enhanced unification of laws in these areas at the international level, particularly in the field of contract law. Another reason is that nowadays the national legal systems tend to recognize the broadened party autonomy principle, which governs a wider scope of issues than merely contractual disputes.

II. Property Rights (Real Rights)

- 3 In modern society, real rights carry fundamental significance. Almost all state laws contain concrete rules governing various types of real rights, and such rights are deemed as an important aspect of citizen rights. Under Chinese Law, though real rights have a broad coverage, they are divided by art. 2 RRL into movables, immovables, and certain rights as prescribed by law. The term “real rights” means the exclusive right of direct control over a property enjoyed by the holder in accordance with law, including ownership, usufructuary rights, and real rights for security.
- 4 That the law should protect citizens' real rights is a well-established principle. This principle is partly recognized and codified by the RRL. As discussed in Chapter 13, leading Chinese civil law experts opine that art. 66 of the RRL actually denies the

³ 专利法, promulgated on 12th March, 1984 and effective from 1st April, 1985; last revision effective from 1st October, 2009.

⁴ 著作权法, promulgated on 9th July, 1990 and effective from 1st June, 1991; last revision effective from 1st April, 2010.

⁵ 商标法, promulgated on 23rd August, 1982 and effective from 1st March, 1983; last revision effective from 1st December, 2001.

equal protection of private property and state property because it obviously prioritizes the protection of state property.⁶

It is interesting to note that the RRL does not contain rules on conflict of laws. 5 According to its art. 8, in cases where other laws contain special provisions regarding real rights, such laws shall apply. Therefore, the LAL will be applied to determine the applicable law of foreign-related real rights issues, according to which different types of real rights are governed by different rules on conflict of laws. Although real rights issues are among the most important and complicated legal issues, the rules on applicable laws, with regard to real rights issues, are not always so complicated thanks to various well-established principles.

1. Immovables

Generally, it is necessary and a general practice to distinguish immovables from 6 movables in law. Such a distinction is not only relevant to the jurisdictional issue of real rights disputes, but is also connected to the disposal of such rights. It has been well established that the law applicable to immovables is the law of the place where such estates are located (*lex rei sitae*).

This rule was formerly recognized by art. 144 GPCL and later codified by art. 36 7 LAL. Art. 36 LAL does not distinguish the different aspects of immovables; thus, it should be understood that the *lex rei sitae* governs all aspects of immovables, unless otherwise provided, including the ownership, sale, lease, use, establishment, modification, assignment, extinction, and legal protection of such immovables. Given such a broad coverage of this provision, it is even suggested that this LAL provision does not contain any exceptions.⁷

2. Movables

An important implication of distinguishing immovables from movables lies in that 8 they are subject to different applicable laws. Compared with immovables, the law applicable to movables has undergone substantial changes in the past centuries. Formerly, movables were governed by the *lex personalis* of their owners. Since the 19th century, this rule gradually became obsolete due to the frequent cross-border

⁶ See generally LIANG Huixing, 114-128.

⁷ WAN E'xiang, 270.

movements of persons and the development of international commercial transactions. Following such a trend, some states began to apply the *lex rei sitae* rule to movables. More recently, with the rapid economic development, various states began to adopt the party autonomy principle in order to determine the law applicable to movables.

- 9** In China, the GPCL and its relevant judicial interpretations do not contain any express rules regarding the law applicable to the movables. This vacuum is filled by the LAL, following recent international legislative trends. According to art. 37 LAL, parties may reach an agreement regarding the law applicable to the movables; absent such agreement, the *lex rei sitae* (where the legal relations occurred) is applied. This provision is applied to a broad range of aspects of foreign-related civil relations relating to movables, including the ownership, use, type, contents, establishment, modification, assignment, termination as well as legal protection of such movables.
- 10** Under Chinese law, there are a few exceptions to art. 37 LAL. For instance, movables in transit are a typical exception. Generally, it is almost practically impossible to determine a certain location of movables in transit as such location is constantly changing. Therefore, art. 38 LAL provides that the law applicable to such estates is subject to the parties' agreement; and absent such agreement, the applicable law is the law of the destination of the transportation.

3. Securities

- 11** There is no unified definition of the term securities as different states have different legal systems and commercial practices. However, it is generally agreed that securities as such should possess certain elements: they should be negotiable, carry certain value, and represent certain rights independent from its holder.
- 12** In practice, there might be many ways to classify securities. For instance, according to art. 2 of the Securities Law⁸, securities include corporate bonds, stocks, or others types of securities as approved by the State Council. Art. 71 of the Maritime Law deals with commonly seen types of securities, for instance, bill of lading. Similarly, art. 2 of the Negotiable Instruments Law provides that negotiable instruments may

⁸ 证券法, promulgated on 29th December, 1998 and effective from 1st July, 1999; last revision effective from 1st January, 2006.

refer to money orders, checks, and/or promissory notes. Besides, as previously mentioned, Chapter 5 of the Negotiable Instruments Law also provides for several rules on conflict of laws for foreign-related securities.

In contrast, the LAL fails to expressly provide what types of securities it governs. **13** Thus, it is at the discretion of the court to decide whether a certain type of securities falls under the scope of application of the LAL. This is to say, the LAL is supplementary to the above securities laws. In other words, the LAL shall be applied if the previous laws are not applicable or do not contain rules on conflict of laws. According to art. 39 LAL, securities are governed either by the law of the place where the rights in respect of securities are to be exercised, or by any other law to which the securities are most closely connected. Since the LAL is unclear on the connecting factors which are needed to decide on the law most closely connected, it is subject to the discretion of the courts.

4. Pledge of Rights

According to art. 223 RRL, at the outset, there are various types of rights on which a **14** pledge can be established, including (1) money orders, checks, and promissory checks; (2) bonds and deposit receipts; (3) warehouse receipts and bills of lading; (4) transferable fund units and stock rights; (5) assignable property rights of trademark rights, patent rights, copyrights, etc; (6) receivables; and (7) other property rights that can be pledged as prescribed by law.

With regard to the law applicable to a pledge of rights, the RRL is silent. Again, the **15** LAL fills the gap. According to art. 40 LAL, a pledge of rights is governed by the law of the place where the pledge is established. As the LAL is silent as to what place is deemed as the place the pledge is established, one must resort to the respective substantive laws. On this issue, arts. 224-228 of the RRL provide guidance. According to these provisions, the place of establishment of the pledge is generally the registration place of such pledge. Such rules on conflict of laws echo the compulsory requirement of registering a pledge of rights as prescribed in these provisions.

III. Contract

16 Given the practical importance of a contract, contract law is deemed a key instrument in almost all state legal systems. In nature, a contract is an agreement between two or more parties that dispose of their civil rights and thereby create certain obligations to one another. Art. 2 of the Contract Law (CL) clearly recognizes that a contract is an agreement created to establish, modify or terminate the civil rights or obligations between equal natural persons, legal persons, and organizations. Contracts are divided into a number of major types, such as sales contracts, lease contracts, transportation contracts. Contract law regime is a complicated one, touching upon various aspects of legal issues, such as formation, legal effects, modification, termination, performance, breach, and remedy of a contract. The applicable law issues relating to foreign-related contracts are mainly embodied in a special chapter of the GPCL, art. 126 CL, the LAL, and various SPC judicial interpretations.

1. The Party Autonomy Principle

- 17** Since the mid-20th century, party autonomy has been widely recognized as a fundamental principle of private international law. Under Chinese law, subject to a few exceptions, this principle is applied to settle applicable law issues in various types of legal disputes, including both international disputes and inter-regional disputes.⁹
- 18** The applicability of the party autonomy principle to foreign-related contractual disputes has long been confirmed in Chinese law. It was first provided by art. 145 GPCL and later in art. 126 CL. The relevant parts of both provisions provide that parties to a foreign-related contract may choose which law to apply to their contractual disputes, except when the law has other provisions. Absent such a choice, the law that bears the closest connection with the contract is applicable.
- 19** The same position was recently codified in art. 41 LAL. According to this provision, parties may agree to choose the law applicable to their contract. Absent such a choice, the law of the place where the party, who is required to effect the characteristic performance of the contract, has its habitual residence or any other

⁹ XIAO Yongping/LONG Weidi, 195.

law to which the contract is most closely connected is applicable. In practice, parties are only allowed to choose substantive law instead of procedural law. Besides, parties may choose a law to govern their contract that bears no connection with the contract, unless such a choice violates the mandatory rules of Chinese law.¹⁰

Despite China's explicit recognition of the party autonomy principle, it is still **20** necessary to further discuss several operational aspects of this principle, such as the time for parties to conclude their agreement on the choice of law, the formal requirements of the parties' choice as well as the restrictions and exceptions of this principle.

First, the LAL is silent as to the time frame for parties to make an agreement on the **21** choice of law. In general, it is accepted that parties may choose the law applicable to their contract either before or after the conclusion of the contract or before a dispute arises. Some state laws also allow parties to modify their original choice of law. In this regard, the Rules of the SPC on the Relevant Issues concerning the Application of Law in Hearings on Foreign-Related Contractual Disputes in Civil and Commercial Matters (SPC Judicial Interpretation No. 2007-14)¹¹ contains clear guidance. According to art. 4 of the SPC Judicial Interpretation No. 2007-14, if the parties conclude an agreement on the choice of law before the end of the first instance court hearing, the agreement will be allowed. In *Guangzhou Xianyuan Real Estate Co. Ltd v Guangdong Zhongdazhongxin Investment Planning Co. Ltd, Guangzhou Yuanxing Real Estate Co. Ltd, and China Investment Group International Finance Ltd*¹² concerning a contract for the transfer of company shares, the SPC, based on this provision, ruled that Chinese contract law should be applied because all of the parties had agreed to it during the court hearing. There are other cases where the parties make their agreement on the choice of law during the court hearings, some even during the hearing of the second instance.¹³ Though scholars called for more explicit rules regarding the time frame for parties to conclude an agreement on the choice of law, the LAL has left this issue undefined.

¹⁰ WAN E'xiang, 297.

¹¹ 最高人民法院关于审理涉外民事或商事合同纠纷案件法律适用若干问题的规定, promulgated on 11th June, 2007 and effective from 8th August, 2007.

¹² 广州市仙源房地产股份有限公司与广东中大大鑫投资策划有限公司、广州远兴房产有限公司、中国投资集团国际理财有限公司股权转让纠纷案, judgement of the SPC dated 30th December, 2009.

¹³ See XIAO Yongping/LONG Weidi, 199-200.

- 22 Second, the LAL is silent with regards to the methods of choosing applicable law. SPC Judicial Interpretation No. 2007-14 fills this gap. According to art. 3, parties may choose or modify the law applicable to their contract in an explicit manner. Here, a possible scenario is that the parties fail to explicitly conclude an agreement on the choice of law, but if one party cites a certain law as applicable law and the other party fails to object in a timely manner, then this law will be deemed as the applicable law chosen by both parties. This position is firmly supported by the recent SPC Judicial Interpretation No. 1 on Certain Issues Relating to the Application of the LAL.¹⁴ According to Art. 8 of the Judicial Interpretation, the court should allow the parties to conclude or modify their choice of law agreement before the closing of the hearing of the first instance, and if both parties cite the law of the same state and neither party makes objections, the court should find that the parties have reached a choice of law agreement.
- 23 Third, the LAL also fails to define the scope of laws that parties may choose, except where it states that the law should only be substantive law. Specifically, art. 41 LAL is silent as to whether parties are allowed to choose supra-national or transnational rules, such as an international convention, international trade usage, or the *lex mercatoria* that belongs to no state law system. Admittedly, this issue is too broad to fit the purpose of this book, yet it is true that difficulties may arise if parties choose such rules to be applied to their contract. On this issue, it might be argued that the LAL, by using the term “law” instead of “rule”, impliedly limits the parties’ freedom to choose state laws, but not transnational rules, unless these rules are codified by state laws. Such a conclusion is based on the intricate but fundamental distinction between the terms “law” and “rule”. In short, as pointed out by *Vogenauer/Kleinheisterkamp* while discussing the applicability of the UNIDROIT Principles of International Commercial Contract (UNIDROIT Principles), “law” generally refers to the laws of a state, while “rule” often refers to both rules of a state law and rules of other sources such as the *lex mercatoria*. Indeed, it is based on such a distinction that they conclude that the UNIDROIT Principles and other *lex mercatoria* rules could only qualify as rules rather than as laws.¹⁵ In light of such a

¹⁴ 《最高人民法院关于适用〈中华人民共和国涉外民事关系法律适用法〉若干问题的解释（一）》SPC Judicial Interpretation No.1 on Certain Issues Relating to the Application of the LAL, adopted by the Judicial Committee of the SPC at its 1563rd Meeting on 10th December, 2012, *Fa Shi* (2012), 24.

¹⁵ See *VOGENAUER/KLEINHEISTERKAMP* (eds.), 42.

distinction, the LAL provision can only be interpreted as to prohibit the parties from choosing transnational rules to govern their contract.

Interestingly, despite this interpretation, judicial practices of Chinese courts are **24** divergent in this regard. According to a survey conducted by *Xiao Yongping* and *Long Weidi*, some courts seemed to uphold the parties' choice of transnational rules, while others did not. For instance, in a foreign-related contractual dispute, the High Court of Jiangsu Province upheld the parties' choice of the Uniform Rules for Collection to govern their contract. And the two authors further argued that such a decision is challengeable because under Chinese law, transnational rules can only be applied as international trade usages, and that parties are not allowed to choose these rules as applicable law.¹⁶ Yet, a different understanding could be that the parties may choose transnational rules to govern their contract, but that such rules are to be treated as contractual terms instead of applicable law. However, as art. 41 LAL has not been tested in judicial practice to date, it remains to be seen whether this provision can effectively limit the freedom of the parties' choice of law.

Finally, despite the fundamental role of the party autonomy principle, parties' **25** freedom in choosing the law applicable to their contract is not unlimited. Almost all state laws recognize certain restrictions and exceptions to this principle. A typical example of such an exception can be found in art. 145 GPCL and art. 126 CL. According to both provisions, the parties' free choice can only be exercised where the law has no other provisions. Art. 126 CL in its second paragraph clearly excludes three types of Sino-foreign contracts, namely, contracts for Sino-foreign equity joint ventures, contracts for Sino-foreign contractual joint ventures, and contracts for Sino-foreign cooperative exploration and the development of natural resources to be performed within the territory of the PRC. Furthermore, these contracts must be governed by Chinese law.

In addition to the above-mentioned explicit limitations on party autonomy, there are **26** also other various restrictions that should be decided on by courts on a case-by-case basis. Under the LAL, there are at least two types of exceptions, namely mandatory rule exception and public policy exception. As mentioned earlier, art. 4 LAL provides that the mandatory rules of PRC law are to be directly applied to foreign-related civil relations, implying that the parties' choice of law, if it exists, will

¹⁶ See *XIAO Yongping/LONG Weidi*, 201.

not be applied. Art. 5 LAL provides that if the application of a foreign law hurts the social and public interests of China, then the PRC law will apply. In practice, the difference between these grounds is not always sufficiently clear, and it is possible for an agreement on the choice of law which violates mandatory rules to be deemed as violating public policy.

- 27** Concerning the public policy exception, Chinese law does not contain an express definition thereof. Thus, the invocation of this exception in foreign-related cases is left to the discretion of the courts. It is admitted that this exception must be invoked with extreme caution so that it is not abused.¹⁷ As surveyed by *Xiao Yongping/Long Weidi* in China's judicial practices, this exception has been invoked in several foreign-related cases. For instance, in *Bank of Communications (Hong Kong) v Tan Liyi* and *Wellbleton Chemical Ltd. and Bank of China (Hong Kong) v Zhenjiang Light Industry United Co., Ltd.* the parties chose the law of Hong Kong as the applicable law to their contracts. Yet, because China adopts a strict control over foreign exchange issues, such contracts should be governed exclusively by Chinese law. For this reason, the courts held that the choice of law clauses were invalid as they violated China's public policy.¹⁸
- 28** The mandatory rules exception is an express denial of the party autonomy principle. For instance, in *Tongchuan Xinguang Aluminum Ltd. v Bank of China (Hong Kong)* concerning a guarantee agreement which designated Hong Kong law as the applicable law, the court invalidated this choice of law and applied Chinese law. According to the court, as Chinese law requires a guarantee in order to file with local authorities constitutes a mandatory rule, and because the guarantee agreement in this case failed to be fulfilled, it was thus invalid according to the applicable Chinese law.¹⁹ Yet the difficulty is, since Chinese law neither contains a clear list of mandatory rules nor provides a clear guidance to identify such rules, it would be quite difficult for the contractual parties, particularly foreign parties, to foresee what rules would be deemed by the Chinese courts as mandatory rules.

¹⁷ See, e.g. *HUANG Jin*, 219; *XIAO Yongping*, 136.

¹⁸ See generally *XIAO Yongping/LONG Weidi*, 204.

¹⁹ See generally *XIAO Yongping/LONG Weidi*, 207.

2. The Closest Connection Principle

The closest connection principle is also deemed as one of the fundamental rules on **29** conflict of laws in dealing with contractual relations, often supplementing the party autonomy principle. Furthermore, this principle is expressly recognized by Chinese law. As provided in the latter halves of art. 41 LAL, art. 145 GPCL and art. 126 CL, if the parties fail to reach an agreement on the choice of law, the law which bears the closest connection with the contract will apply. Yet, with the expansion of international commercial activities, a foreign-related contract may often involve many different countries and legal systems. Thus, to correctly apply the closest connection principle, it is imperative to determine which law bears the closest connection with the contract. It is at this point that state laws differ. Some provide possible laws which could be deemed as having the closest connection with the contract, while others simply leave this matter to the discretion of a judge.

Judicial practices show that Chinese courts generally base their decision on the **30** characteristic performance of the contract. According to this practice, it is presumed that the contract is most closely connected with the country where the party was to effect the performance which is characteristic of the contract, at the time of conclusion of the contract. Indeed, this approach is the one most frequently employed by Chinese courts when making applicable law decisions, although these courts often fail to provide sufficient reasoning for their decisions.²⁰ Despite its frequent use, the closest connection principle sometimes lacks effectiveness, since it is difficult to decide what performance should be deemed as characteristic in some types of contracts. In order to address such problems and to better guide local courts in making applicable law decisions in foreign-related contractual disputes, the SPC Judicial Interpretation No. 2007-14 further elaborates on the closest connection principle in an interesting way.

According to art. 5 of the SPC Judicial Interpretation No. 2007-14, the closest **31** connection principle should not be deemed as a single rule but a cluster of rules, and that the judges or arbitrators do not have full discretion to decide which rule bears “the closest connection” with the contract by following the test of characteristic performance. More specifically, this provision, although initially recognizing the

²⁰ HUANG Jin/SONG Lianbin/Li Qingling/LONG Weidi, 715, 725.

closest connection principle, divides foreign-related contracts into 17 general types, and provides 19 different sets of rules on conflict of laws to be applied to each type of contracts. For instance, the law that has the closest connection with an international sales contract is the law of the state where the seller has his domicile when the contract is concluded, whereas the law of a foreign-related construction contract is the law of the state where the construction site is located. Therefore, in a practical sense and as an exception, only on contracts that fall outside the 17 prescribed types of contracts can a judge or arbitrator exercise their discretion in order to decide the law that bears the closest connection with the contract.²¹

3. Consumer Contract

- 32** In nature, consumer contracts are not different from other types of sales or construction contracts in that they are agreements between equal parties to establish mutual civil rights and obligations. However, since consumers and sellers often have mismatched negotiating powers and imbalanced information, it would be difficult for consumers to conclude well-informed contracts with sellers. Thus, many states have begun to adopt a policy of enhanced consumer protection by separating consumer contracts from general sales contracts. They aim to provide consumers, the weaker party of the contract, with more protection.
- 33** Under Chinese law, the substantive rules for consumer protection are contained mainly in the Law of Protection of Consumer Rights and Interests (Consumer Protection Law)²², the Law of Food Safety²³, the Product Quality Law²⁴, and their implementing rules and relevant SPC judicial interpretations. These laws fail to provide express procedural rules regarding foreign-related consumer protection issues. This gap is filled by art. 42 LAL: “A consumer contract is governed by the law of the consumer’s habitual residence. If the consumer chooses to apply the law of the place where the product or service is to be supplied, or if the business operator has no related business activity in the place of the consumer’s habitual residence, the law of the place where the product or service is to be supplied shall be applied.”

²¹ *Chi Manjiao*, 351-352.

²² 消费者权益保护法, promulgated on 31st October, 1993 and effective from 1st January, 1994; last revision effective from 27th August, 2009.

²³ 食品安全法, promulgated on 28th February, 2009 and effective from 1st June, 2009.

²⁴ 产品质量法, promulgated on 22nd Februar, 1993 and effective from 1st September, 1993; last revision effective from 8th July, 2000.

As can be seen, this provision does not simply follow the party autonomy principle, **34** but rather grants the power over the choice of law to the consumer alone. This is in order to enable the consumer to choose the law that is more favorable to him (*lex favoritstis*), and is deemed as an improvement of Chinese law.²⁵ Besides, with regard to the time frame for the consumer to choose the applicable law, it has been suggested that, in judicial practices, consumers should be allowed to choose the applicable law even after a dispute arises until the end of the first court hearing. It has been further suggested that, in dealing with foreign-related consumer contract disputes, the court should explain to the consumer that he enjoys the exclusive right to choose the applicable law, and only when the consumer expressly refuses to choose the law of the place where the product or service is to be supplied, can the court apply the law of the consumer's habitual residence.²⁶

Art. 42 LAL treats consumer contract as a special type of contract, different from the **35** 17 types of contracts identified by the SPC Judicial Interpretation No. 2007-14. By specifying the uniqueness of the consumer contract, the LAL not only reflects the prevailing consumer protection policy, but also limits the applicability of the principles of party autonomy and closest connection to general contracts. Given such a rule, a precondition to invoke art. 42 LAL is to identify a contract as a consumer contract. At this point, art. 7 LAL provides that the *lex fori* is to be applied to identify or characterize the civil relations. In this sense, art. 42 LAL cannot be deemed as self-sufficient and it can only operate in conjunction with other rules.

If a Chinese court is required to decide the law applicable to an alleged foreign- **36** related consumer contract, Chinese law should be applied to decide *a priori* if this contract is indeed a consumer contract. However, Chinese law does not provide a clear definition of a consumer contract. Although art. 2 of the Consumer Protection Law protects “consumers who purchase or use commodities, or receive services”, it is too generalized to determine if, for example, a consumer should be protected for purchasing immovables, or for receiving medical or financial services. Such identification could be particularly difficult considering that the SPC Judicial Interpretation No. 2007-14 already identifies 17 different types of contracts and provides specific rules on conflict of laws for each of them. A consumer contract

²⁵ Yu Ying, 65, 66.
²⁶ WAN E'xiang, 306.

must demonstrate certain uniqueness vis-à-vis these 17 types of contracts to qualify for art. 41 LAL.

- 37** On this issue China's judicial practices are inconsistent. But a pro-consumer policy seems to be evolving. For instance, in *Jinjiang Metro Supermarket Guangzhou, Tianhe Market v Zhou Wenhua*, Zhou Wenhua went to Tianhe Market to purchase his daily goods and parked his car in the parking lot provided by the Market. The car was later found stolen while Zhou was shopping, and Zhou claimed compensation against the Market in Guangzhou Tianhe District Court. The Court in the first instance held that when Zhou was shopping in the Market, the parking service provided by the Market should also be deemed as a service of the Market under art. 2 of the Consumer Protection Law, although the Market clearly posted that it should not be held responsible for any loss or damage that happen in the parking lot. Following this line, the Court ruled in favor of Zhou. This judgment was later upheld by Guangzhou Intermediate Court.²⁷ Despite the diversified judgments, it has been suggested that Chinese courts should take a flexible but cautious attitude when identifying consumer contracts, considering that state laws may have different definitions of consumer.²⁸

4. Employment Contract

- 38** An employment contract, also known as labor contract in China, generally refers to an agreement concluded between the employer and the employee on their respective obligations and rights which arise out of their employment relations. As such contract involves both property issues and personal issues, and reflects the evolving labor protection standards, it is often treated as a special type of contract and is thus governed by special laws in many states.
- 39** In China, employment contract issues may carry extra political implications as they are deemed by the state as a factor to evaluate the construction of the heavily propagated "harmonious society". To be specific, under Chinese law, the substantive aspects of an employment contract are mainly governed by the Labor

²⁷ *Jinjiang Metro Supermarket Guangzhou Tianhe Market v. Zhou Wenhua* (锦江麦德龙现购自运有限公司广州天河商场等与周玟华等消费服务合同纠纷上诉案): 2010 Sui Zhong Fa Min Er Zhong Zi No. 531, available at <http://vip.chinalawinfo.com>.

²⁸ WAN E'xiang, 305.

Contract Law²⁹, the Labor Mediation and Arbitration Law³⁰, and the relevant SPC judicial interpretations.

Concerning the law applicable to employment contracts, many state laws often treat such contracts differently from general contracts. Specifically, state laws, while taking into consideration the mismatched negotiating powers between the employer and the employee, are often inclined to grant more protection to the employees, the weaker party of the contract, and to restrict the application of the party autonomy principle. There are good reasons for such restriction, particularly in light of the recent trend of enhanced human rights protection. **40**

Art. 43 LAL divides foreign-related labor contracts into general labor contracts and outsourcing services (labor dispatching) contracts, governed by different sets of rules on conflict of laws. According to this provision, a labor contract is governed by the law of the employee's working place. If the employee's working place cannot be identified, the law of the employer's principal business place will be applied. Labor dispatch contracts are allowed to be governed by the law of the actual working place. The rationale of this provision is two-fold: on the one hand, this provision reflects the general pro-employee policy; on the other hand, it also reflects the closest connection principle. It has been suggested that in foreign-related labor contractual relations, the place where the contract is concluded often differs from the work place, and the latter should be deemed as more closely connected with the labor contract. This understanding also conforms to art. 41 LAL, which explicitly provides for the closest connection principle to be applied to a contract in general. **41**

Notwithstanding art. 43 LAL, judicial practices seem to suggest that Chinese courts follow a certain pattern in making applicable law decisions in foreign-related labor contract disputes: the first step is to apply the mandatory rules of Chinese law, if applicable; the second step is to apply the law of the work place of the employee; and the third step, as a supplement to the second step, is to apply the law of the employer's principal business place in cases where the employee's working place cannot be identified. Here, Chinese law is silent as to what rules are mandatory; thus, it is to be decided at the courts' discretion on a case-by-case basis. **42**

²⁹ 劳动合同法, promulgated on 29th June, 2007 and effective from 1st January, 2008.

³⁰ 劳动争议调解仲裁法, promulgated on 29th December, 2007 and effective from 1st May, 2008.

IV. Tort

- 43 Tort law is probably one of the most important and developed branches of law in many legal systems. Due to their different social backgrounds and legislative approaches, state laws are quite diverse with regard to tort, including the elements of tort, the obligations incurred by tort, and the remedies and indemnities available for the aggrieved party. Today, with the unprecedented expansion of cross-border communications, foreign-related tort issues are also on the rise.
- 44 With regard to China, the Law on Tort Liability and the GPCL (Section 3 of Chapter 6) stand as the core of China's tort law system, providing various substantive rules to govern all types of tort in general. Concerning rules on conflict of laws in foreign-related tort disputes, the dictum of *locus regit actum* has been widely established. Thus, in many legal systems, the law applicable to tort disputes should be the law of the place where the tort occurred (the *lex delicti*).
- 45 In China, the relevant rules on conflict of laws applied to foreign-related tort disputes are provided mainly by art. 146 of the GPCL and relevant SPC judicial interpretations. According to art. 146, *lex delicti* is applied to handle compensation claims for any damage caused by tort. If both parties share the same nationalities or domicile states, their common national law (*lex patriae*) or the law of their common domicile (*lex domicilii*) will be applied. Art. 146 GPCL incorporates the "double actionability principle", meaning that an act is held liable as tort only when it is deemed as such under both the foreign law and Chinese law. According to this provision, an act committed outside China's territory is not treated as tort if, under Chinese law, it is not considered as such. Technically, art. 146 GPCL does not provide any guidance for identifying the *lex delicti* in a given case. Art. 187 of the Opinions on GPCL makes up the vagueness by providing that the *lex delicti* may either be the law of the commission place of the act of tort or the law of the place where the consequence of such an act occurred. In cases where these two places are different, the court may exercise discretion to choose one. In general, these two provisions conform to the international consensus of applying the *lex delicti* in foreign-related tort disputes, though the GPCL provision also allows for a deviation from such consensus.

46

The above provisions were later repealed when the LAL came into force. Under the LAL, there are several provisions dealing with the applicable law issue in foreign-related tort disputes. Technically, the LAL first draws a distinction between tort in general and three special types of tort, and then designs different types of roles on conflict of laws to be applied to these different types of torts. More specifically, art. 44 LAL provides for tort in general, while arts. 45-46 LAL deal respectively with product liability and infringement on personality rights (including online infringement). Naturally, according to the dictum of *lex specialis derogat generali*, arts. 45-46 should take precedence in application *vis-à-vis* art. 44.

1. Tort in General

As mentioned above, art. 44 LAL deals with the law applicable to tort in general. 47 According to this provision, liability in tort is governed by the law of the place where the tortious act occurred. However, if the parties have a common place of habitual residence, the law of their common place of habitual residence will apply. If, after the occurrence of the act, the parties reach an agreement on the choice of applicable law, their choice is to be followed. Reading this provision carefully, one is able to identify a three-step approach in handling foreign-related tort disputes by Chinese courts: (1) the law of the parties' choice applies; (2) absent such choice, the law of the common place of the parties' habitual residences applies, if it exists; and finally, failing the second step, the *lex delicti* applies. Though practically speaking, the *lex delicti* may refer to either the law of the tort commission place or the law of the place where the consequence of the tort will occur, the LAL provision fails to clarify this issue.

Although art. 44 LAL is deemed as *lex posterior* vis-à-vis the above provisions of the GPCL and the Opinions on GPCL, it is still of interest to briefly compare them. 48 Obviously, compared with the provisions of the GPCL and the Opinions on GPCL, the LAL provision follows their position at the outset of applying the *lex delicti* in foreign-related tort disputes. Yet, these provisions also bear several differences.

First and foremost, art. 44 LAL incorporates the new international trend of applying 49 party autonomy in foreign-related tort disputes. The latter half of this provision clearly provides that the parties may choose a law to govern their dispute after the occurrence of an act of tort. This is deemed as a fundamental change compared

with the GPCL provision. Art. 44 LAL is silent as to the time frame and form by which the parties must make such a choice of law. But it has been suggested that the parties may make their choice of law agreement either in written or oral form, and they may do so before the end of the court hearing of the first instance of their dispute.³¹ It has also been argued whether allowing the parties to choose the law applicable to foreign-related tort disputes could hurt China's public order. Such concern is unnecessary, because on the one hand, art. 4 LAL clearly states that the mandatory rules of Chinese law directly apply, disregarding the parties' choice of law; on the other hand, art. 5 LAL provides that the application of the law of the parties' choice shall not conflict with China's social and public interests. With such statutory restrictions in place, even permitting the parties to choose the law applicable to foreign-related tort disputes, China's public order is not likely to be endangered.

- 50** Second, art. 44 LAL, compared with the GPCL provision, further clarifies the scope of the law applicable to foreign-related tort disputes. This provision requires the court to apply the law of the parties' common place of habitual residence, if it exists. This approach abandons the connecting factors of domiciles and nationalities of parties, which is believed to be more up-to-date given the fact that a habitual residence is generally deemed to bear a closer connection with the party in practice.
- 51** Finally, art. 44 LAL, unlike art. 146 GPCL, clearly deletes the double actionability requirement. Indeed, the abolishing of this requirement has aroused much attention and heated debate during the making of the LAL, as many scholars felt that such a requirement was necessary for protecting China's public policy. Finally, it was generally agreed that this requirement may be deleted, because, as mentioned above, art. 4 (mandatory rule clause) and art. 5 (public interest clause) LAL can render sufficient legal protection for China's public policy.
- 52** Ironically, despite all the credits of art. 44 LAL, its defects were revealed and amplified by the recent express train collision accident of Wenzhou on 23rd July, 2011, only a few months after the LAL took effect. The relevant fact is that several foreign passengers, citizens of the U.S. and Italy, were killed in the train accident. Since tort law in the U.S. and Italy provide a much higher compensation standard compared with Chinese law, the families of the victims claimed compensation under

³¹ *WAN E'xiang*, 313.

US law and Italian law, respectively, and opposed the application of PRC law as proposed by the Ministry of Railway.

Here, assuming that a Chinese court were to decide the applicable law issue, the 53 above three-step approach (*supra* at 47) shall come into play. The first step will fail since it is obvious that the parties cannot reach an agreement on the choice of law. The second step is also likely to fail because many foreign victims were simply tourists and have no habitual residence in China. Finally, the third step is to be taken, which means the *lex delicti* should be applied. Yet, as mentioned above, the LAL is silent as to what law should be deemed as the *lex delicti*, the law of the place of commission (in such case the applicable law is PRC Law) or the law of the place where the consequence of this tort occurs (in such case the applicable law could be US law or Italian law). Obviously, because China's tort law and the US and Italian tort laws have different compensation standards, the final outcome of these claims could be substantially different depending on the applicable laws.³²

In a sense, such an awkward situation is understandable because the LAL has a 54 short history and thus has not been sufficiently tested. In the meantime, it has to be noted that such defects are not unique to art. 44 LAL alone. Other LAL provisions could also suffer from their vagueness. Thus, it is suggested that relative rules on implementation and SPC judicial interpretations should be made as soon as possible to guide Chinese courts in order to correctly apply the LAL provisions.

2. Product Liability

In recent decades, with the rapid technological and economic development and the 55 international sale of products, together with the recent trend of enhanced consumer protection, disputes caused by or connected with defective products or improper use of products have been on the rise. Many states gradually realize that product liability issues are no longer mere contractual issues, but are tort issues as well. The general thread running through such a shift in attitude lies in the enhanced policy of consumer protection.

Chinese law lists product liability tort as a special type of tort (*supra* Chapter 12 at 56 48 *et seqq.*). In China, product liability laws are rather new and their rules are quite

³² See generally *Huo Zhengxin*, 11-16.

scattered. Except for the above-mentioned art. 146 GPCL, which applies to tort in general, Chinese law still lacks rules on conflict of laws to deal with foreign-related product liability issues. Such a situation is incapable of meeting the practical need of enhanced consumer protection in China. It is particularly the case considering that art. 146 GPCL generally requires the courts to apply the *lex delicti* in foreign-related tort disputes; however, this law could be quite accidental and does not necessarily bear any connection with the dispute.

57 Interestingly, before the LAL came into force in April 2011, many Chinese consumers witnessed the defects of the rules on conflict of laws contained in the GPCL. For instance, Toyota, one of the biggest automobile producers in the world, announced a recall of more than 1.5 million cars of various brands globally in 2010. Among these recalled cars, nearly 200 thousand were sold in the Chinese market. Some Chinese consumers who were not satisfied with Toyota's solutions tried to claim damages against Toyota in Chinese courts. Yet, in these cases, the *lex delicti*, either the law of the place of commission or that of the place of consequence of such tort, clearly refers to the Chinese law, particularly the Product Quality Law and the Consumer Protection Law. However, compared with the U.S. or Japanese tort laws, these Chinese laws provide for a very low compensation standard for product liability. Therefore, the consumers were not likely to claim for higher compensation compared with the US or Japanese consumers. As a result, many Chinese consumers criticized the low compensation standards of Chinese laws and called for an enhanced level of consumer protection. However, many of them overlooked the procedural loophole of Chinese law that the rigid rule on conflict of laws contained in art. 146 GPCL should also be blamed for such consequences.

58 As illustrated above, due to the fact that, on the one hand, the substantive rules of Chinese tort laws often fail to provide sufficient protection for consumers; on the other hand, the rules on conflict of laws of Chinese tort laws are often too rigid to make it possible for Chinese consumers to claim for better compensation, many Chinese consumers choose to file claims for compensation in foreign courts concerning product liability as far as they can.³³

59 Realizing such procedural defects of Chinese law and learning from the rules of relevant international law instruments, such as the 1973 Hague Convention on the

³³ WAN E'xiang, 321.

Law Applicable to Product Liability, the LAL created new rules on conflict of laws.³⁴ According to art. 45 LAL, product liability is governed by the law of the aggrieved party's habitual residence. If the aggrieved party chooses to apply the law of the infringer's principal business place or the law of the place where the damage occurred, or if the infringer has no related business activity in the place of the aggrieved party's habitual residence, then the law of the infringer's principal business place or the law of the place where the damage occurred will apply.

Compared with the GPCL provision, this provision represents a progress in various 60 senses. First, this LAL provision is tailored exclusively for product liability issues and is thus more specific in application. It also helps to correct the rigidity and vagueness of the GPCL provision by clearly recognizing several connecting factors. Particularly, it clearly abandons the traditional rule of the *lex delicti*; rather, it incorporates the place of the occurrence of the damage to avoid the vagueness and inconsistency of interpreting the *lex delicti*. It should also be mentioned that the LAL provision allows party autonomy in limited scenarios. According to this provision, the aggrieved party (often the consumer) may unilaterally choose either the law of the infringer's principal place of business or the law of the place where the damage occurred. This provision grants a chance for the aggrieved party to choose a more favorable law after comparing these two laws, and thereby grants the greatest possible level of protection to the consumer. Regarding the concept of "the principal place of business", according to art. 14 LAL, it impliedly refers to the place of the legal person's habitual residence. Concerning the definition of "the place where the damage occurred", Chinese law is silent. Yet, it has been suggested that, by following the closest connection principle, such a place should be the place of the aggrieved party's habitual residence.

In light of the above analysis, it is suggested that, in practice, the court employs a 61 four-step approach when applying this provision. First, the court should inquire whether the parties have any agreement on the choice of law, and if so, then said law will apply. Second, if there is no such agreement, the court should, pursuant to the unilateral choice of the aggrieved party, apply either the law of the infringer's principal place of business or that of the place where the damage occurred. Third, absent such a choice, the court should, at its own discretion, apply one of these

³⁴ WAN E'xiang, 321.

laws. Finally, the catch-all method is for the court to apply the law of the aggrieved party's habitual residence.

3. Infringement on the Rights of Personality via the Media

- 62** Generally, the rights of personality are deemed as a new type of rights in civil law. It may also be roughly deemed as a moral right. In modern era, with rapid technology development and the expansion of communications, particularly the emergence of the internet and other “new media” technologies, infringement on a citizen's rights of personality via the media, and the internet in particular, has become an international phenomenon. Indeed, this is also a relatively new problem faced by Chinese law, although such cases are frequently seen nowadays.
- 63** Such development seriously challenges the existing framework of private international law in China. China does not have a uniform media law or journalism law. Thus, infringement on the rights of personality via the media falls under the scope of application of the Law on Tort Liability and relevant GPCL provisions. However, as these laws govern all types of torts without identifying their characteristics, they are often insufficient to satisfactorily deal with certain special types of torts, such as infringement on the rights of personality via the media. They are insufficient mainly because they fail to recognize the uniqueness of a tort via the media and are particularly incapable of balancing the need to protect the rights of personality and the need to defend the freedom of speech, the freedom of journalism, and the right to know.³⁵
- 64** Besides, Chinese law does not contain a separate subsystem of rights of personality, and rules in this regard are scattered. Section 4, Chapter 5 of the GPCL provides for several types of such rights, such as the right of life, health, name, image, and so on. The first section of art. 1 of the SPC Interpretation on Certain Issues Relating to Determining the Liability for Moral Damages in Civil Tort³⁶ also lists several types of rights of personality which are permissible for litigation in Chinese courts: (1) rights of life, health, and body, (2) rights of name, image, reputation, and honor; and (3) rights of dignity and physical freedom. Despite having

³⁵ See generally *YANG Lixin*, 15-31.

³⁶ 最高人民法院关于确定民事侵权精神损害赔偿若干问题的解释, promulgated on 8th March, 2001 and effective from 10th March, 2001.

such a list, the second section of art. 1 provides that the aggrieved party may initiate lawsuits in Chinese courts for infringement on the “other rights of personality”. Such wording suggests that the list of rights in art. 1 is not exhaustive. Based on such understanding, it is suggested that, although China lacks a separate subsystem of rights of personality, such rights should not be too narrowly construed in judicial practices.

Concerning the law applicable to infringement disputes concerning the rights of personality and the media, existing state laws take different approaches. Some follow the traditional rule of *lex delicti*, some provide that the national law of the aggrieved party applies, some allow the aggrieved party to choose the applicable law from a limited number of laws, while some follow the closest connection principle.³⁷ As far as China is concerned, before the LAL came into force, art. 146 GPCL was applied to foreign-related infringement disputes on rights to personality via the media. However, as mentioned, since art. 146 governs tort in general and rigidly sticks to the *lex delicti*, it is unreasonable to apply it to such new type of infringement dispute. It would be particularly unreasonable in disputes concerning infringement via the internet since, in such cases, it is often impossible to identify the *lex delicti*. 65

Art. 46 LAL is ambitious to confront such problems. Pursuant to this provision, liability for infringement on the rights of personality, such as those concerning a person’s name, image, reputation, and privacy, either via the internet or by other means, is governed by the law of the aggrieved party’s habitual residence. Compared with the GPCL, the LAL’s preference for habitual residence has its rationale. First, there is a close connection between the aggrieved party’s habitual residence and the infringement on his moral rights, because his residence is generally the “seat” of his social relations. Second, practically speaking, the habitual residence is comparatively easier to be identified in an internet environment, compared with other connecting factors, such as the infringer’s nationality or the place of commission of the infringement. 66

Besides, this LAL provision is quite special. On the one hand, it is notable that it expressly incorporates the wording “via the internet” to show its determination to combat the rampant foreign-related online infringements on the rights of personality. 67

³⁷ See generally *WAN E’xiang*, 326-328.

On the other hand, though it is silent as to whether the parties are allowed to choose the applicable law by agreement, such party autonomy should be allowed according to art. 44 LAL, which governs torts in general.

- 68** Yet, despite all the merits of art. 46 LAL, this provision is not free from criticism. One typical criticism is that, in this regard, it overlooks the drastic difference of state laws, which could possibly result in a lower level of protection for Chinese citizens. Another typical criticism is that it fails to give sufficient consideration to certain internationally recognized principles, such as freedom of speech and freedom of journalism; thus, Chinese courts could find it difficult to balance the need to defend these principles and the need to protect a citizen's right of personality. As this provision has not been tested in practice, it remains to be seen how it will do in the real world.

V. Unjust Enrichment and Management without Mandate

- 69** In civil law, both unjust enrichment and management without mandate are important sources of obligations. Historically, these two concepts derive their origins from Roman law. Today, state laws are quite diversified on these issues due to their different legal traditions. Under Chinese law, the most pertinent rules governing these two types of obligations are arts. 92 and 93 GPCL. Art. 92 contains the definition of unjust enrichment, providing that if a benefit is acquired without legal basis and results in another person's loss, then said benefit must be returned to the person who suffered the loss. Art. 93 defines management without mandate, providing that if a person manages or serves for the protection of another person's interests without statutory or contractual obligation, he will be entitled to claims from the beneficiary for any expenses accrued from such acts.
- 70** Despite their difference, these two concepts are closely interconnected. It is also for such reasons that they are sometimes subject to the same set of rules on conflict of laws. In China, before the adoption of the LAL, there were no rules on conflict of laws which govern these two types of obligations. In practice, unjust enrichment and management without mandate are generally identified as general tort and thus are governed by art. 146 GPCL. However, as mentioned, art. 146 cannot satisfy the practical need for its generality.

The LAL is the first Chinese law that expressly deals with the applicable law issues 71 of unjust enrichment and management without mandate. According to art. 47 LAL, an obligation arising from unjust enrichment or management without mandate is governed by the law chosen by the parties. Absent such a choice, the law of the parties' common habitual residence applies; absent such a residence, the law of the place where the unjust enrichment or management without mandate occurred applies. This provision embodies a clear three-step structure. It not only recognizes and follows the traditional rule of *lex delicti*, but more importantly, it also recognizes and prioritizes the principles of party autonomy and closest connection (habitual residence). As mentioned earlier, according to arts. 3 and 4 of the SPC Judicial Interpretation No. 2007-14, the parties may explicitly choose the applicable law and may do so before the end of the court hearings of the first instance. In a sense, it seems that China has changed its previous judicial attitude of treating unjust enrichment or management without mandate as a general tort.

VI. Intellectual Property Rights (IPRs)

In the modern era, the importance of IPRs is internationally highlighted. Due to their 72 very nature, international protection of IPRs remains a difficult problem to many states, particularly developing countries. The uniqueness of IPRs derives mainly from their conflicting private and public natures: from the perspective of the IPRs holders, state laws must protect them to benefit from their intellectual achievements; from the perspective of the society, state laws must also restrict IPRs holders from monopolizing their achievements so that the public can also benefit. Such tension could be particularly high if IPRs are granted for medicines and other important innovations.

The sources of China's IPRs law are quite complicated and diverse. China has 73 acceded to more than 10 international conventions to date. Just to list a few chronologically: the Paris Convention on the Protection of Industrial Property (Paris Convention) and the Convention Establishing the World Intellectual Property Organization (WIPO Convention) in 1980, the Madrid Agreement for International Registration of Trademarks (Madrid Agreement) in 1989, the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention) in 1992, the Rome Convention for the Protection of Performers, Producers of Phonograms and

Broadcasting Organizations (Rome Convention) in 1993, and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) in 2001. At a national level, China has enacted laws for almost every aspect of IPRs, such as patent, trademark, copyright, and other types of IPRs.

74 Although these international conventions and domestic laws provide for a sound legal system for the protection of IPRs, they generally do not contain rules on conflict of laws and are unable to provide procedural rules to solve foreign-related IPRs disputes. Before the adoption of the LAL, art. 146 GPCL, governing tort in general, was applied to identify the law applicable to foreign-related IPRs disputes. Yet, as mentioned, art. 146 was unable to meet the practical need for settling these disputes satisfactorily due to its rigidity and generality. Such a situation has been somehow worsened in light of the fact that recent technological innovations have greatly complicated foreign-related IPRs disputes. To address such challenges, the LAL provides a chapter composed of three rules on conflict of laws to exclusively deal with various aspects of foreign-related IPRs disputes.

1. Entitlement and Contents of Intellectual Property Rights

75 Due to the different levels of social development and background, state laws have different definitions or scopes of IPRs. For the purpose of this book, there is no need to list the definition of any specific state, a glimpse at the two major IPR conventions should suffice. According to art. 2 of the WIPO Convention, IPRs are divided into eight major types. Para. 8 of art. 2 is especially a catch-all clause, which is argued by some scholars to be able to cover all possible types of IPRs. Such a broad definition has been furthered by the more recent TRIPS Agreement, which not only clearly recognizes the existing IPRs conventions, but offers enhanced protection to a broad range of IPRs.

76 Given the diverse definitions of IPRs in state laws, in order to deal with foreign-related IPR disputes, a precondition is to identify whether a certain right claimed for protection could qualify as an IPR. In this regard, art. 48 LAL provides that the entitlement to and the contents of IPRs are governed by the law of the place where protection is claimed.

77 At the outset, it has been suggested that the term “contents” in this provision should be broadly construed to cover the acquirement, effects, scope, duration of

protection, and termination of the IPRs. In this sense, art. 48 LAL should be deemed as a general law vis-à-vis the ensuing two provisions, which dealing respectively with the transfer and license (art. 49) and infringement (art. 50). Given that the entitlement of IPRs is often very closely connected with the transfer or licensing of IPRs via contracts, it is possible for art. 48 to overlap with the rules on conflict of laws governing foreign-related contracts. On this issue, the dictum *lex specialis derogat legi generali* should be followed, meaning that the latter rule, instead of art. 48, should be applied.

The core element of art. 48 is the law of “the place where the protection is claimed”. **78** It is suggested that such place should be differentiated from the place of forum and the place where the claim is raised. Rather, the place should be interpreted as the place for which the protection is claimed.³⁸ This is because IPRs protection is territorial in nature, and a certain IPR may be afforded a different level and type of protection under different state laws. Thus, it is not always reasonable to apply the *lex fori* since the place of forum does not necessarily bear a close connection with the IPR. In practice, “the place for which the protection is claimed” should be decided depending on the specific IPR being claimed. For IPRs which are automatically acquired, such as copyright, such a place generally refers to the place where such claim is raised, while for a patent or trademark which is not automatically acquired, such a place often refers to the place of registration of such a right.

2. Transfer and Licensing of Intellectual Property Rights

Transfer and licensing of IPRs are deemed as contractual relations under most **79** national legal systems, though such contracts could be categorized into various different types of contracts, such as an exclusive license or a sole license. As a contract, it would only be reasonable for the transfer and licensing of foreign-related IPRs to be governed by the party autonomy principle. This is indeed confirmed in the first paragraph of art. 49 LAL, which provides that the parties may choose the law applicable to the transfer and licensing of intellectual property rights. Absent such a choice, the relevant provisions in the LAL apply.

³⁸ WAN E'xiang, 348.

- 80** However, as mentioned, the party autonomy principle must always be considered in conjunction with other applicable provisions, such as arts. 4 and 5 LAL. Art. 4 LAL, in particular, provides for the mandatory rule exception. Under Chinese law, there are quite a few recognized mandatory rules applied to the transfer and licensing of IPRs. For instance, art. 39 of the Trademark Law provides that the transfer of a trademark should be conducted in the form of a transfer of contract by the parties. The transfer must be notified publicly upon approval, and the transferee acquires the trademark right from the day of the notification. In light of art. 4 LAL, this provision shall prevail over the law chosen by the parties.
- 81** The second paragraph of art. 49 LAL deals with the situation where the parties fail to conclude an agreement on the choice of law. In this regard, art. 49 does not provide a clear rule on conflict of laws, but rather directs to the “other relevant rules” of the LAL. Under the LAL, this provision actually directs to art. 41, which provides for the general rule of the law applicable to a contract. According to art. 41, as mentioned earlier, the law which bears the closest connection with the transfer and licensing of IPRs should be applied by following the characteristic performance test. Given that the transfer or licensing of IPRs is quite different from general types of contracts, the applicable law should be determined on a case-by-case basis, subject to the court’s discretion.

3. Intellectual Property Rights Infringement

- 82** IPRs infringement is one of the most common types of tort. It is particularly the case in developing countries due to their low protection standards for IPRs and insufficient IPR law enforcement capacities. For instance, due to the different protection levels of IPRs in China and some developed states, China has been criticized by many states, particularly developed states, for failing to provide sufficient and prompt protection to IPRs.
- 83** Art. 50 LAL provides that the liability for the infringement of IPRs is governed by the law of the place where protection is sought. The parties may, after the occurrence of an infringing act, choose to apply the law of the forum. At the outset, it is of interest to construe the wording of art. 50 in light of art. 48. Art. 50 draws a clear line between “the place where the protection is claimed” and the place of forum by treating them as different connecting factors. This actually enhances the

interpretation of art. 48, which states “the law of the place where protection is claimed” is not deemed as an equivalent to the *lex fori*. Besides, judging from the wording of art. 50, it should be a catch-all provision dealing with all types of IPR infringement disputes. As a general rule, this provision is quite similar to art. 44 LAL, which deals with torts in general. Thus, art. 50 should be deemed as the *lex generali vis-à-vis* art. 44.

Para. 1 of art. 50 recognizes that the law applicable to the infringement of foreign- 84
related IPRs should be that of the place where the protection is claimed, which, in practice, often leads to the *lex delicti*, although they are not necessarily identical in many disputes. Para. 2 of art. 50 confirms that the parties have a certain choice of law freedom, though limited only to the *lex fori*. Indeed, it is still debatable whether parties should be allowed to choose the applicable law in foreign-related IPRs infringement disputes. Some argue that the IPR law has fundamental bearings with the public policy of a state; thus, parties should not be allowed to legally evade the application of the state law. While objectors point out that such a public policy argument is not well grounded and that party autonomy may inject more flexibility to the process of determining the applicable law in order to help solve complicated cross-border IPRs infringement disputes. As a result, as is shown by the wording of para. 2, art. 50 is a compromise. On the one hand, it clearly embraces the party autonomy principle, but on the other hand, limits such autonomy to the *lex fori*.

Despite the catch-all nature of art. 50, for a lack of explicitness, this provision may 85
not be sufficiently capable of addressing all foreign-related IPRs infringement disputes. For instance, as to the infringement of IPRs via the internet and IPR-related competition disputes, it is unclear whether “the law of the place where protection is claimed”, as provided in para. 1, could satisfactorily address the challenges posed by these new types of disputes. At this point of time, it remains to be seen how this provision actually operates in practice.

Relevant Laws & Regulations

Title	Promulgation Date	Effective Date	Last Revision Effective from
Hague Convention on the Service Abroad of Judicial and Extra-Judicial Documents in Civil and Commercial Matters (关于向国外送达民事和商事司法文书和司法外文书的海牙公约)	11/15/1965	For China, 1/1/1992	---
Marriage Law (婚姻法)	9/10/1980	1/1/1981	4/28/2001
Nationality Law (国籍法)	9/10/1980	9/10/1980	---
Constitution (宪法)	12/4/1982	12/4/1982	3/14/2004
Trademark Law (商标法)	8/23/1982	3/1/1983	12/1/2001
Rules on the Implementation of Law in Sino-Foreign Equity Joint Ventures (中外合资经营企业法实施条例)	9/20/1983	9/20/1983	7/22/2001
Patent Law (专利法)	3/12/1984	4/1/1985	10/01/2009
Succession Law (继承法)	4/10/1985	10/1/1985	---
General Principles of Civil Law (民法通则)	4/12/1986	1/1/1987	27/8/2009
Notice of the Supreme People's Court on Enforcing the Convention of Recognition and Enforcement of Foreign Arbitral Awards (最高人民法院关于执行我国加入的《承认及执行外国仲裁裁决公约》的通知)	4/10/1987	4/10/1987	---
Opinions of the Supreme People's Court on Certain Issues concerning the Implementation of the General Principles of Civil Law of the People's Republic of China(Trial) (最高人民法院关于贯彻执行《中华人民共和国民法通则》若干问题的意见(试行))	1/26/1988	1/26/1988	Several Articles abolished on 12/24/2008
Basic Law of the Hong Kong Special Administrative Region (香港特别行政区基本法)	4/4/1990	7/1/1997	---
Basic Law of the Macao Special Administrative Region (澳门特别行政区基	3/31/1990	12/20/1999	---

本法)

Copyright Law (著作权法)	7/9/1990	6/1/1991	4/1/2010
Civil Procedural Law (民事诉讼法)	4/9/1991	4/9/1991	1/1/2013
Law on the Protection of Minors (未成年人保护法)	9/4/1991	1/1/1992	6/1/2007
Adoption Law (收养法)	12/29/1991	4/1/1992	4/1/1999
Opinions of the Supreme People's Court on Certain Issues Arising from the Application of the Civil Procedural Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见)	7/14/1992	7/14/1992	12/24/2008
Maritime Law (海商法)	11/7/1992	7/1/1993	---
Product Quality Law (产品质量法)	2/22/1993	9/1/1993	7/8/2000
Convention on the Protection of Children and Cooperation in Respect of Inter-Country Adoption (跨国收养方面保护儿童及合作公约)	5/29/1993	4/27/2005 (For PRC)	---
Law of Protection of Consumer Rights and Interests (消费者权益保护法)	10/31/1993	01/01/1994	08/27/2009
Company Law (公司法)	12/29/1993	7/1/1994	1/1/2006
Arbitration Law (仲裁法)	8/31/1994	9/1/1995	8/27/2009
Bilateral Agreement on Civil, Commercial and Criminal Judicial Assistance between the People's Republic of China and the Arab Republic of Egypt (和阿拉伯埃及共和国关于民事、商事和刑事司法协助的协定)	12/29/1994	5/31/1995	---
Negotiable Instruments Law (票据法)	5/10/1995	1/1/1996	8/28/2004
Notice of the Supreme People's Court on Certain Issues concerning the Handling of Foreign Arbitration and Foreign-Related Arbitration (最高人民法院关于人民法院处理与涉外仲裁及外国仲裁事项有关问题的通知)	8/28/1995	8/28/1995	12/31/2008
Civil Aviation Law (中华人民共和国民用航空法)	10/30/1995	3/1/1996	---
Law of Protection of the Rights and Interests of the Elderly (老年人权益保障法)	8/29/1996	10/1/1996	8/27/2009

Securities Law (证券法)	12/29/1998	7/1/1999	1/1/2006
Contract Law (合同法)	3/15/1999	10/1/1999	---
Registration Rules on Adoption by Foreigners in the People's Republic of China (外国人在中华人民共和国收养子女登记管理办法)	5/25/1999	5/25/1999	---
Arrangement between Mainland China and the Hong Kong Special Administrative Region on the Mutual Recognition and Enforcement of Arbitral Awards (最高人民法院关于内地与香港特别行政区相互认可和执行仲裁裁决的安排)	1/24/2000	2/1/2000	---
Interpretation of the Supreme People's Court on Certain Issues Relating to Determining the Liability for Moral Damages in Civil Tort (最高人民法院关于确定民事侵权精神损害赔偿责任若干问题的解释)	3/8/2001	3/10/2001	---
First Interpretation of the Supreme People's Court on Certain Issues in the Application of Marriage Law of the People's Republic of China (最高人民法院关于适用《中华人民共和国婚姻法》若干问题的解释(一))	12/24/2001	12/27/2001	---
Regulation on Marriage Registration (婚姻登记条例)	7/30/2003	10/1/2003	---
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Labor Contract Law (劳动合同法)	6/29/2007	1/1/2008	---
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Arrangement between Mainland China	12/12/2007	1/1/2008	---

and the Macao Special Administrative Region on the Mutual Recognition and Enforcement of Arbitral Awards (最高人民法院关于内地与澳门特别行政区相互认可和执行仲裁裁决的安排)

Labor Mediation and Arbitration Law (劳动争议调解仲裁法)	12/29/2007	5/1/2008	---
Arrangement between Mainland China and the Hong Kong Special Administrative Region on the Mutual Recognition and Enforcement of Civil and Commercial Judgments in Cases of Consensual Jurisdiction (最高人民法院关于内地与香港特别行政区法院相互认可和执行当事人协议管辖的民商事案件判决的安排)	7/3/2008	8/1/2008	---
Law of Food Safety (食品安全法)	2/28/2009	6/1/2009	---
Law on Tort Liability (侵权责任法)	12/26/2009	7/1/2010	---
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SPC Judicial Interpretation No.1 on Certain Issues Relating to the Application of the LAL 《最高人民法院关于适用〈中华人民共和国民事诉讼法〉若干问题的解释（一）》	12/10/2012	1/7/2013	---