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A Comparative Study of Party Autonomy

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Dr Junwei Fu is currently teaching at Beijing Institute of Technology School of Law.From 2002 until 2006, Junwei Fu obtained his Bachelor of Laws from China. In June 2007, he graduated from his Master in International Economic and Business Law at University of Groningen Law School, the Netherlands. Throughout his academic career, Junwei Fu received a number of scholarships and honours. From September 2007 to August 2010, he worked as a Ph.D. researcher in Tilburg University Law School. During the period from August 2008 until August 2009, Junwei Fu was a visiting scholar at Washington University School of Law in St. Louis, United States. Since August 2010, he has been promoted as an Assistant Professor in Tilburg University Law School. In addition, he has been working for the China desk of the law firm of VMW in Amsterdam.

List of Abbreviations

Acquis Group	Research Group on the Existing EC Private Law
AIC	Administration of Industry and Commerce of China
CAOs	Collective Employment Contracts
CFR	Common Frame of Reference
CISG	1980 United Nations Convention on Contracts for the International Sale of Goods
CLC	The Contract Law of the People's Republic of China
DCFR	Draft Common Frame of Reference
ECJ	European Court of Justice
EU	European Union
GPCL	The General Principles of the Civil Law of the People's Republic of China
NPC	National People's Congress of China
PECL	Principles of European Contract Law
Resolution	Resolution of the Strengthening of the Work of Interpretation of Law (1981)
SCNPC	Standing Committee of the National People's Congress
SMEs	Small- and Medium-Sized Enterprises
SPC	Supreme People's Court of China
SPP	Supreme People's Procuratorate of China
Study Group	Study Group on a European Civil Code
Unidroit Principles	Unidroit Principle of International Commercial Contracts
WTO	World Trade Organization

Foreword

This book represents the first extensive comparative study of party autonomy in contract law in the European Union (EU) and China. It emphasizes fundamental contrasting notions and approaches to party autonomy, both on a theoretical level and in various concrete doctrines, such as interpretation, contract validity, adaptation of contract, termination, mandatory rules and the constitutionalization of contract law. The book is well timed: both in the EU and in China the society efforts to effect contract law reforms are currently underway.

It is to be expected that these reforms will not be put through in isolation from each other, since China is now the EU's second biggest, and the EU, China's biggest trading partner, and because of exposing Chinese contract law to global and European development, has been part of a process of accommodation that started in the 1980s. The study offers a meaningful and outspoken contribution to this process, for example, by pointing out that the influence is mutual rather than unidirectional and that certain Chinese doctrines, such as the adaptation of contracts in case of fraud and threat, are more sophisticated than their EU counterparts.

The book is also a foundation for future research and elaboration in the ongoing debate in the EU and China on improving contract law. At this point differences arise. Should these improvements aim at promoting welfare, remedying market failures, serving state interests, protecting the weaker party, establishing an area of freedom, security and justice in which persons, goods, capital and services move freely, or some sort of prioritized mix of these goals?

Junwei Fu, was educated in China at Hu'nan Agricultural University. He has published several articles on EU contract law and on the comparison with Chinese contract law in, for example, the Oxford University Comparative Law Forum, the Civil and Commercial Law Review (Beijing), the Journal of the Party School of the Central Committee of the Communist party of China (Beijing)and, most recently,

in a book with Prof. Liang Huixing (eds.) published by Martinus Nijhoff, *Draft Civil Code of* People's Republic of China.

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Preface

The law of contracts in fact, is to make the individuals exercise their freedom without any damage to others. Freedom of contract can be regarded as one of the most fundamental principles in the law of contracts, which ultimately serves the private autonomy of individuals. However, the exercise of freedom cannot impair others' interests and the welfare of the state. So the law of contracts has to set out parameters of good faith and fair dealing, social justice, and human rights among others, which have a mandatory nature, as binding rules to ensure that freedom is well exercised. In brief, contract law consists of the rules that recognize freedom and set out some limitations to restrict it. The default rules provide the freedom, which guides the parties to conclude the contract while also filling in the gaps in the contract, whereas the mandatory rules restrict the individuals' freedom since the parties can only be bound by them without any other choice. It is reasonable to say that the law of contracts is constructed around the principle of the freedom of contract.

In ancient China, Confucianism had been the dominant thought ruling society since the *Han* dynasty to maintain the hierarchy of the state, and it continues to influence the Chinese methods of living and thinking today. The key value of Confucianism is self-cultivation, which can be seen as a remarkable limitation to party autonomy since it lays down a great deal of rules for people to behave obediently. Among those values, morality (*li*), which is to instil in the individual, an inner sense of awareness of the acts that are shameful, or propriety, has a significant impact on civil society. Civil issues were, then, considered minor matters, whose resolution was suggested through extra-legal mechanisms, such as mediation. The transplantation of modern civil law into China began in the early 1900s, and the first draft of the Chinese civil code, which is mainly based on the German and the Japanese civil codes, was completed in 1911. In the later decades, several draft civil codes had been completed. However, Chinese legal

history mentions that a draft civil code was only implemented for a short time between 1928 and 1930, though it is still in force in Taiwan today. After the establishment of the People's Republic of China, until the 1980s, it is true to say that policy assumed the role of law in society. The primary development of modern Chinese civil law began from the 1980s when the open-door policy was implemented. It is thus true to conclude that in ancient China, the system and the concepts of modern civil law were absent, and the dominant thought was to restrict party autonomy and promote the hierarchy of the state.

In the 1980s, three contract laws namely, the Economic Contract Law, the Technology Contract Law, and the Foreign Economic Contract Law were implemented. However, after the 1990s with the advent of the market economy, The Contract Law of the People's Republic of China (CLC) was drafted to replace the three contract laws of the 1980s. But The General Principles of the Civil Law of the People's Republic of China (GPCL), which was adopted in 1986, is still being implemented and serves as the basic principle for Chinese civil law, and even the future civil code.

On the contrary, in Europe, Roman private law and its centuries-long scholarly interpretations have contributed to a solid foundation for the development of modern European private law. The principle of freedom of contract, in particular, a reflection of party autonomy, had become a fundamental rule since the 1800s. However, in recent years, especially since the 1980s, the Europeanization of private law has become a hotly discussed issue, and it would be correct to say that consumer protection since then has embarked upon this process of Europeanization. In the past several decades, the directives have played an important role in the converging of European private law, which consists of the primary part of *acquis communautaire*. However, the convergence was not satisfactory, and in academia, it is argued that the diversity of private law constituted obstacles to the development of a single-market economy, and the value of social justice needs to be promoted. A uniform civil code has since then been advocated.

However, the idea of a uniform civil code presents numerous problems for the EU society such as: (1) whether the EU has the power to adopt a civil code; (2) is it feasible to adopt a civil code for the EU; and (3) how to construct this civil code. As is widely known, the law of contracts constitutes the main part of the private law. The Lando Commission completed the drafting of the Principles of European Contract Law (PECL) in 2003 to enable development of a single-market economy. This Commission's work has been subsequently continued by the Study Group of von Bar. The Draft Common Frame of Reference (DCFR) is the result of the efforts of the Study Group together with the *Acquis* Group. As the PECL and the *acquis communautaire* have been integrated into the DCFR, which is a possible model for the political Common Frame of Reference (CFR) advocated by the European Commission, it is true to say (a part of) the DCFR can most probably be endowed with some legal effects by the official organs, or at least it can assist development of the future European private law as it has provided some concrete issues for discussion. Also, the purpose of the DCFR drafting committee, consisting of about 250 scholars and lawyers, is to find the common core of European private law.

So until now, the DCFR/PECL is one of the most appropriate places to look for the current and future European contract law, though its ability to represent the common rules of Europe is still being discussed.

In modern contract law, party autonomy as expressed in the idea of the freedom of contract is a fundamental principle in most countries, and people have struggled for centuries for it. Both the CLC and the DCFR/PECL follow this tendency. Under the DCFR/PECL, the parties are endowed with the freedom to enter into the contract, choose the other party, and determine the contents of the contracts. It does the function of serving the free market within the EU. However, the freedom is not arbitrary. It has to be restricted by good faith and fair dealing, social justice, and fundamental rights. But on the contrary, in China, the concept of the freedom of contract has not been clearly stated, and only the notion of contract voluntariness is used instead. To some extent, the reluctance to use the term 'freedom of contract' reveals the obstacles in recognizing party autonomy in China, mainly due to the influence of Confucianism and Socialism. However, although the freedom is not clearly stated in the CLC, voluntariness still has to be restricted to the socio-economic valuation, which consists of traditional social ethics and the current economic situation. In the case of traditional social ethics, the CLC is influenced by good faith, fairness and public interest, which are consistent with the values of Confucianism. As to the current economic situation, the principle of equal status and the promotion of business transactions, which are aimed at fostering the development of market economy, are observed as the fundamental principles mentioned in the CLC and directed at restricting the individual's freedom. Since party autonomy, a more philosophical concept, serves as the basis of the freedom of contract, it is reasonable to conclude that party autonomy in Europe has a wider scope than in China, since the freedom of contract has been obviously recognized in Europe and is limited to good faith and fair dealing, social justice and fundamental rights, whereas in China the contract voluntariness is used instead of 'freedom of contract', and this is limited to good faith, fairness, public interest, equal status, and the promotion of business transactions. This difference can be reasonably explained using the different roles and functions of party autonomy, which are rooted in the historical and cultural backgrounds. Although modern Chinese contract law is a transplant from the Western countries, each term possibly has different meanings after it is combined with the national characteristics. The concept of 'freedom of contract' is the obvious example. When it was transplanted into China, the concept was changed to mean a voluntariness of entering into a contract, and the reason of this change was attributed to the deeply influential thoughts of Confucianism and the ideology of Socialism, both of which are reluctant to accept the ideology of party autonomy. Also, public interest is a fundamental principle in the CLC, which is absent under the DCFR/PECL. Although it can be observed in all the national private laws that the individual's freedom cannot be violated, in China this concept is understood broadly to include collective interests and interests of the state and parties. This difference is due to the Socialist background of China and the fact that collective interests are certainly superior to personal interests, the assumption of which is also consistent with Confucianism,

which advocates that personal interests are subject to public interest. It is thus true to say that, the differences in contract law between Europe and China can be reasonably concluded as, party autonomy which is influenced by both, historical and cultural backgrounds.

The conclusion can be tested by a detailed doctrinal comparison. It is worth mentioning that in Chapter 3, there is no in depth analysis of each doctrine as this may lead to each doctrine being written as a separate book. However, this dissertation attempts to make a hypothesis and test whether the same can be falsified, which makes it more interesting as this attempt may lead to an in depth comparison in the future. Therefore, from the general description of the comparison of each of the doctrines, it may be satisfactory that if there are differences then they can be used to test whether the hypothesis can be falsified.

For the interpretation of the contract, both the DCFR/PECL and the CLC set out the common intention as the standard for the judges to dig out for their interpretation. However, in the CLC, the concept of true meaning is used although it is argued to be equivalent to the Western concept of common intention. This difference is also attributed to Chinese history, for in traditional China, the judges were encouraged to discern the truth between the parties, based on which modern Chinese contract law could adopt the concept of true meaning. Also, in the DCFR/PECL, the preliminary negotiation and subsequent conduct are relevant circumstances, which the judges have to consider, whereas in the CLC they are not stated as relevant situations. As the preliminary negotiation and subsequent conduct refer to the communication between the parties, it is from these relevant circumstances that mutual intentions can be better observed. It is thus correct to say for the purposes of interpretation that the DCFR/PECL is more respectful towards subjective minds of the individuals, which is an expression of party autonomy. However, in both the DCFR/PECL, party autonomy has to be limited to good faith and fair dealing, social justice and the protection of human rights. *Contra proferentem* is an obvious rule flowing from justice, which is an exception to subjective interpretation, as the rule is to maintain the substantive fairness between the parties and to give an interpretation against the party, which provides the standard contract. However, after the comparison, it is easy to see that in the CLC, the *contra proferentem* rule is only limited to the standard contract, whereas under the DCFR, it is extended to the party which can dominantly influence the contract although the terms have even been negotiated. So it is reasonable to say that in the DCFR, fairness is interpreted more broadly to protect the weaker party than in the CLC.

The same can be observed in the pre-contractual liability, which focuses on maintaining the value of good faith and fair dealing between the parties. Individuals are free to decide on whether to enter into a contract. However, good faith and fair dealing is the primary limitation to the exercise of this freedom, and both the DCFR/PECL and the CLC set out several rules to penalize the party, which negotiates in bad faith. A difference in pre-contractual liability between the DCFR and the CLC is seen in the DCFR, where the information duty required in the Consumer Contract Law has a lower standard than in the CLC. Under the DCFR, the parties have to disclose information, which can be reasonably expected by the other party,

whereas in the CLC, a deliberate intention to conceal is the standard to measure such duty. So it is true to say that in the DCFR, the concept of (substantive) fairness covers a wider scope than in the CLC.

The validity of contract is subsequently compared, and includes the traditional defective of wills covering 'mistake', fraud and threat, and the recent development on unfair bargaining power. To address mistakes, the CLC uses the concept of significant misunderstanding, which has a broader scope than the concept of mistake explained in the DCFR/PECL, as the former refers to any misconception about the law, the facts and the contract itself, whereas the latter concerns itself with the misconceptions about the law and the facts only. Both, significant misunderstanding and mistake require the misconception to be material. However, in the CLC, the material is determined by the objective method that demands the consequences of serious loss. On the contrary, in the DCFR/PECL, this is judged by the subjective way which entails that the party should know or expect to have known that the other party would not enter into the contract if he knew the truth. As to the fraud and threats, the constitutional elements are similar in both, the DCFR and the CLC. However, as to the effects of these in the DCFR/PECL, the contract can only be void if it was concluded under fraud or threats, whereas in the CLC, three types of effects such as, adaptation, avoidance and invalidity are outlined. Under the CLC, if the defect does not harm the interests of the state, then, the contract can be adapted or avoided, otherwise it can only be invalid. It is difficult to give a reasonable explanation to all these differences in meaning between contract laws in Europe and China. However, it is obvious in the CLC, from the aspects of fraud and threat, that unless the public interest is set at a high level, which no contract can touch; otherwise the contract will certainly be invalid.

The recent movements on unfair bargaining power are ultimately to maintain substantive fairness between the parties, which restrict individual autonomy. The rules on unfair exploitation and unfair terms have been regulated in both the DCFR and the CLC. However, it is obvious that the provisions with regard to unfair terms in the DCFR are more concrete and detailed than in the CLC, which can be easy for the parties to predict the consequence of their conducts. Except for this, the non-individually negotiated terms are within the scope of (substantive) unfairness in the DCFR. It is therefore true to conclude that (substantive) fairness has a broader scope in the DCFR and aims at protecting the weaker party.

With regard to recognition of party autonomy, both the DCFR and the CLC acknowledge that the contract can be adapted or terminated mutually by the parties. However, with regard to the mutual intention to adapt the contract, the CLC sets an additional rule, which requires that the content of modification will be definite, and the registration or approval required by the law or regulations shall be followed for any change. The registration and approval system in China makes it easy for the state to control the contract, which has a close interest in the state or the collective organization. In some contracts, such as the Chinese-foreign joint venture contracts, any modification is effective only upon approval. This difference is obviously derived from the Chinese characteristic of maintaining the welfare of the state. Except for the mutual intention to modify or terminate the contract, both

the DCFR and the CLC set numerous conditions for the party to claim for the adaptation. In the DCFR, there are three conditions under which modifications can be claimed. These are mistakes, excessive benefits or unfair advantages, and change of circumstances, whereas in the CLC, there are two additional conditions, which are fraud and threats which enable modification. This difference can be explained through the traditional theory in European contract law where modification was not widely recognized. Due to this limitation, it is difficult for the current European contract law to broadly accept all types of modifications. However, in China, it is possible to modify contracts concluded under fraud or threat for the promotion of business. With regard to the unilateral termination, both, the DCFR and the CLC set force majeure, frustration, anticipatory repudiation, and unreasonable delay as the basis for termination of contracts. However, in the CLC, an additional provision provides for other laws or regulations, which could be the reasons for the termination of these contracts. This provision is very vague and only an administrative regulation, which may constitute the foundation for the termination of a contract. This difference is derived from the Chinese characteristics, which state that the administrative department has to have a wide power to intervene in private contracts.

The mandatory rules in the contract law itself, under the DCFR state the implementation of good faith and fair dealing into more concrete situations. In the CLC, however, except for good faith and fairness, the public interest is also a primary function of the mandatory rules, which can be demonstrated through the validity of the contract. Last but not the least, differences can be observed from the constitutionalization of the contract law process. In Europe, the protection of human rights has been absorbed into the development of private law since the early twentieth century, and some cases demonstrate that the constitutional rights have been directly applied to private law issues and this has been found at both the national and EU levels. It is true to say that the protection of fundamental rights has become a tendency of modern European private law development. On the contrary, in China, the direct application of fundamental rights to private law cases still meets with many problems, and the recession of the official reply to the *Qi Yuling* case somehow reveals that the direct application of Constitutional Law is not allowed. The same can be observed from the protection of social justice, which is another perspective of looking at the constitutionalization of private law. In recent years, the value of social justice has been strongly advocated in Europe and the DCFR has integrated the social solidity as its overriding principle. The provisions for protection of the weaker party and the consumers under the DCFR are obvious examples to reflect the integration of this value. In contrast, although social justice has been rooted in Chinese society for a long time, it has not been widely conveyed for the protection of the weaker party in the modern contract law.

It is therefore reasonable to conclude party autonomy has been recognized in both, the DCFR/PECL and the CLC. However, in Europe, it is more restricted to good faith and fair dealing, the protection of human rights and social justice, whereas in China, it is more restricted to the collective interests and the welfare

of the state. Although the CLC was drafted at the end of the twentieth century after the market economy was implemented, and though it is largely transplanted from the Western countries, it is now clear that the Chinese characteristics mainly in the expression of the fact that personal interest and freedom are subject to the public interest, and which are derived from the country's own culture and history, are deeply rooted.

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