
| RESEARCH ARTICLE

A Comparative Study of the Chinese Change of Circumstances and the UK Contract Frustration

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| ABSTRACT

This study mainly focuses on the comparative study of the "change of circumstances system" in the contract law of China and the UK. This system is described differently in Chinese and English law. Chinese contract law describes it as "change of circumstances", and English contract law describes it as "contract frustration". Although there are differences in legal descriptions, the connotation and purpose of the two systems are generally similar. Generally speaking, it refers to the occurrence of unforeseen circumstances between the two parties after the conclusion of the contract, which leads to fundamental changes in the basis of performance. If the performance is illegal or fundamentally deviates from the main purpose of the contract, the status of the contract shall be changed or terminated. The purpose of the system is to maintain the fairness of the contract parties, reduce the risk of the contract parties, and promote the stability of the trading market. Some differences have emerged in the judicial practice and legislative expression of the system in the two countries. This study believes that the main reasons are the large differences in the business environment and the theoretical basis of the system between the two countries. Therefore, this study will first compare the theoretical basis of the change of circumstances system in the two countries, and then specifically compare the legislative expression and judicial practice of the system in China and the UK, and analyse the reasons for the difference. It should be stated that this comparative study aims to analyse the differences and find out the reasons for the differences and does not involve the evaluation of the advantages and disadvantages of the system.

| KEYWORDS

Comparative Study, Change of Circumstances, Contract Frustration

| ARTICLE INFORMATION

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1. Introduction

In the contract law of various countries, there is a classic system called "change of circumstances". This system is described differently in Chinese and English law. English contract law describes it as "contract frustration", while Chinese law describes it as "change of circumstances". Although the description of the system is different in the two countries, the connotation is broadly similar. It refers to the occurrence of unforeseeable circumstances between the parties after the conclusion of the contract, which causes fundamental changes in the basis of performance. If the performance is illegal or fundamentally deviates from the contract's primary purpose, the status of the contract shall be changed or terminated. The purpose of this system is to maintain the fairness of both sides of the contract, reduce the risk of both sides of the contract, and promote the stability of the trading market.

2. Methodology

This study compares these two systems' theoretical basis, institutional content and judicial practice in Chinese and English law. Firstly, the theoretical basis is studied through cultural and value comparison methods. Then, through the method of structural comparison, the specific system content is divided into different constituent elements and compared respectively. Finally, through

the method of empirical comparison, it compares the judicial practice and legal consequences. The views and decisions of judges in specific judicial cases were analysed.

3. A Comparison of Theoretical Foundations

According to the general theory, the "change of circumstances" principle originated from the medieval "Glossator". The principle states that every contract is assumed to contain an implied clause that the objective circumstances underlying the contract at its conclusion shall continue to exist. Once such circumstances no longer exist, modification or termination of the contract is granted.¹ (Pascal Pichonnaz, 2015, p.712)

This principle was widely used in the 16th and 17th centuries and was criticised and rejected in the 18th century. By the twentieth century, social and economic living standards had changed considerably. Judges, scholars and legislators have to face the reality that there may be economic inequality between the parties to the contract, forcing them to pursue substantive justice as the legislation's goal. The appearance of the "change of circumstances" reflects the pursuit of substantive justice in modern civil law. "According to the principle of fairness and the principle of honesty and credit, civil jurists put forward the concept of "change of circumstances" in civil law to balance the interests of the parties with the fair value."² (Saul Litvinoff, 1997, p.1645) It can be seen that "change of circumstances" is closely related to the changes in social history. Huge changes in the objective environment challenge contractual relations and their revision. The development of the objective situation requires that the change of circumstances system intervenes in the parties' meaning autonomy to achieve substantive fairness.

Chinese scholar argues: "According to the basic theory of Chinese civil law and contract law, the principle of "change of circumstances" should be one of the crucial principles of the validity of a contract in modern debt law."³ (Ren Chen, 2002, p.135) In other words, when a contract is established, a creditor's right and debt relationship is immediately formed between the two parties, and both parties must strictly perform their obligations according to the terms of the contract. However, the party's strict performance liability is not unchanged. When specific circumstances change, if the legal effect of the original contract creditor's right and debt relationship is maintained, the interests of both parties will be out of balance. Therefore, the "change of circumstances" principle has become a condition to cancel the parties' debts to the contract. Compared with the strict performance principle in contract law, both parties' fairness and interest balance become the value goal that the change of circumstances principle pursues more. When there is a conflict between applying the strict performance principle and applying fairness good faith principles, the law chooses the latter. It can be seen that the theory of change of circumstances is the specific application of the principle of fairness and the principle of good faith.

The "contract frustration" principle in the UK is also precisely the concrete application of fairness, honesty and credit principles. In theories of the common law system, scholars have put forward different theories for the principle of frustrated contracts. These doctrines were presented in the face of enormous changes in social and economic circumstances. As economic activity becomes more frequent than before, many accidents have occurred in reality, which makes absolute contractual liability too arbitrary. At this time, a new theory is needed to deal with such a social environment. Otherwise, all kinds of emergencies in social and economic life will seriously lead to the imbalance of interests between the two parties in the contract, thus destroying the stability of the economic market and breaking the environment of fair competition. The "contract frustration" principle also reflects the traditional "consideration theory" in English contract law. "Under consideration theory, one of the primary conditions for effective contract establishment is that the contract must have practical consideration factors."⁴ (Melvin Aron Eisenberg, 1982, p.640) However, when some circumstances occur, the balance of interests between the two parties is destroyed. If the contract continues, the consideration factor between the two parties will be seriously damaged. Therefore, one of the purposes of "contract frustration" is to pursue the equality of consideration between the parties to the contract, that is, to protect the fairness of the interests of both parties.

Although Chinese scholars did not put forward theories such as substantive justice, the theoretical basis and basic principles of Chinese "change of circumstances" and "contract frustration in the UK are roughly the same. Chinese scholars once put forward the following: "The purpose of applying the change of circumstances is to eliminate the consequences of the severe imbalance of the parties' interests caused by the situation change during the performance of the contract."⁵ (Gendang Zheng, 1995, p.24) This statement shows that the primary goal of applying "change of circumstances" is to balance the interests of the parties, protect the

¹ Pascal Pichonnaz, 'From Clausula Rebus Sic Stantibus to Hardship: Aspects of the Evolution of the Judge's Role' (2015) 2015 *Ius Romanum* 712

² Saul Litvinoff, 'Good Faith' (1997) 71 *Tul L Rev* 1645

³ Ren Chen, 'A Comparative Study between the Theory of Frustration of Contract in British Contract Law and the Theory of Change of Circumstances in Chinese Contract Law' (2002) 32 *Journal of Northwest University* 135

⁴ Melvin Aron Eisenberg, 'Principles of Consideration' (1981-82) 67 *Cornell L Rev* 640

⁵ Gendang Zheng, 'On the principle of change of circumstances and its application' (1995) 5 *Peking University Law Journal* 24

fair competition of the parties and promote the stability of the civil legal relationship. Similarly, in the theoretical interpretation of UK scholars, the contract frustration influenced by substantive justice and consideration theory also includes this purpose.

4. A Comparison of System Content

This paragraph divides the system content of two systems into specific constituent elements for comparison. By comparing the system content after separation, the similarities and differences between the two systems can be seen more intuitively and analysed comparatively.

In *Krell v Henry*, Henry rented an apartment from Krell to watch Edward VII's coronation. However, there was no explicit mention of a coronation in the exchange of messages. Henry paid a deposit of twenty-five pounds. After the king's coronation was cancelled due to illness, Henry used this as an excuse to refuse to pay the remaining 50 rent. Krell sued Henry for the remaining 50 pounds. Ultimately, the court ruled against the plaintiff, and Henry did not have to pay the remaining room fee.⁶ (*Krell v Henry* [1] [1903] 2 KB 740)

There are many disputes about this decision. Some scholars believe that "the two parties did not mention the coronation in their correspondence, so they think the final judgment is unreasonable."⁷ (Thomas Roberts.,2003, p.129)

Justice Williams held that:

The legal question in the case was whether there was an implicit condition on the contract to decide whether both parties knew the contract's purpose was to allow Henry to watch the coronation parade. In response to this question, he argues that the circumstance of the timely occurrence of the coronation procedure need not be explicitly mentioned in the contract but can be inferred from the external circumstances surrounding the contract.⁸ (*Krell v Henry* [1] [1903] 2 KB 740)

In such arguments, it can be seen that the condition of the purpose of the contract is a critical consideration when applying "contract frustration". It also reflects the importance of the reason for "frustration of purpose" in the English contract frustration system. However, Chinese law has different rules on this. "Chinese law has deleted the previously stipulated "failure to achieve the purpose of the contract" in the applicable conditions for "change of circumstances"."⁹ (Ruiping Du.,2021, p.55) In Chinese law, the purpose of the contract can still be realised when a "change of circumstances" is applied. On the contrary, under the force majeure system, the purpose of the contract cannot be realised. This legislative change draws a clear line between "change of circumstances" and the "force majeure" system in Chinese law. Therefore, compared with the UK "contract frustration" system, the scope of jurisdiction of the Chinese "change of circumstances" system is narrower.

According to the applicable requirements of the "change of circumstances" system, Chinese law stipulates that:

After a contract is formed, where a fundamental condition upon which the contract is concluded is significantly changed, which is unforeseeable by the parties upon conclusion of the contract and which is not one of the commercial risks if continuing performance of the contract is obviously unfair to one of the parties.....¹⁰ (Civil Code of the People's Republic of China, Article 533)

According to this legislation, Chinese legal scholars generally believe three major constituent elements exist for the change of circumstances system.

- a. Subjective element: not foreseen by the parties at the time of the conclusion of the contract.
- b. Objective element: Major changes in objective conditions cannot belong to business risks.
- c. Result element: It will cause apparent unfairness if the provisions perform the contract.

In the judgment of *Monarch Steamship v Karlshamms*, the judge stated: "The blocked event must be due to external factors, and it is not established that the blocked event was caused by the error or negligence of a party to the contract."¹¹ (*Monarch Steamship*

⁶ *Krell v Henry* [1] [1903] 2 KB 740

⁷ Thomas Roberts, 'Commercial Impossibility and Frustration of Purpose: A Critical Analysis' (2003) 16 Can JL & Jurisprudence 129

⁸ *Krell v Henry* [1] [1903] 2 KB 740

⁹ Ruiping Du, 'An Interpretation of Circumstantial Change in the Civil Code' (2021) 34 Journal of Shanxi Politics and Law Institute for Administrators, 53,55

¹⁰ Civil Code of the People's Republic of China, Article 533

¹¹ *Monarch Steamship Co Ltd v Karlshamms Oljefabriker* [1949] AC 196

Co Ltd v Karlshamms Oljefabriker [1949] AC 196) This principle is not stipulated in the Chinese "change of circumstances" system. This study believes the apparent loss of fairness stipulated in "Result elements" in Chinese law has a similar legal spirit to the judgment mentioned above. The contract frustration and the change of circumstances are aimed at balancing the interests and fairness of both parties. Suppose one party's fault causes the objective fact leading to the contract frustration. In that case, applying these two systems will lead to the loss of one party's interests and violate the original intention of the system. However, although these two provisions have similar legal pursuits, their actual application is quite different. Because "the change cannot be attributed to either party" as stipulated in the "contract frustration" does not necessarily lead to an "obvious loss of fairness" in the change of circumstances. According to the provisions of Chinese law, even if both parties are at fault, the system can still be applied if the continued performance of the contract does not cause apparent injustice.

Unforeseeability, a subjective requirement, is stipulated in the laws of both countries.

In *Walton Harvey v Walker & Homfrays*, a hotel owner signed a contract with an advertising agency. The contract allows advertising agencies to place glowing ads on hotel roofs. The hotel was subsequently forcibly purchased and demolished by the local authority. The advertising agency sued for breach of contract, and the hotel argued that the contract had fallen through.¹² (*Walton Harvey Ltd v Walker & Homfrays Ltd* [1931] 1 Ch 274)

The court ruled that: "the contract was not frustrated because the hotel should have foreseen that such a situation might occur during the contract term. Therefore, they are liable to pay liquidated damages."¹³ (*Walton Harvey Ltd v Walker & Homfrays Ltd* [1931] 1 Ch 274) This case reflects the "unforeseeable" factor in the contract frustration system. At the same time, this provision is also clearly expressed in the Chinese legislation on the change of circumstances system.

Finally, there is a comparison of the objective elements. Chinese law stipulates that the fact of a change of circumstances cannot be a commercial risk. The author believes this provision can be seen as a supplement to the subjective element of "unforeseeability". This provision further restricts the conditions for applying the change of circumstances system. It imposes an obligation on the parties to anticipate and avoid the commercial risks to which they may be exposed at the time of the conclusion of the contract. In the English contract frustration regime, even if the objective facts that caused the change are commercial risks, the possibility of applying contract frustration is still available as long as it can be proved that it was unforeseeable at the time.

The above comparison shows that the scope of application of the UK "contract frustration" is broader than that of the Chinese "change of circumstances". At the same time, due to the difference in legal systems, Chinese law prefers to set out more restrictions in codified form. On the other hand, UK case law gives the judge more discretion while giving the defendant more freedom to apply for a contract frustration.

5. A Comparison of Legal Consequences and Judicial Practice

This chapter will compare the legal consequences of two systems in the UK and China. First, there are fundamental differences in the legal consequences. The Chinese law provides that: "the party adversely affected may renegotiate with the other party. If negotiation fails within a reasonable period of time, the parties may request a people's court or an arbitration institution to modify or rescind the contract."¹⁴ (Civil Code of the People's Republic of China, Article 533) However, the contract frustration system is as its name suggests. After applying contract frustration, the contractual obligations of both parties shall be discharged, and the contract should be invalid. It can be seen that the legal consequences of these two systems are quite different. Chinese "change of circumstances" system gives both parties the right to renegotiate, and if the negotiation fails, they can apply to the judicial organ for termination of the contract. However, the UK contract frustration system directly sentenced the contract to death. Some scholars believe that: "the exceptionality of applying the Chinese "change of circumstances" system requires minimising interference in the relationship between contractual rights and obligations."¹⁵ (Hengyu Zhou.,2022, p.208) From the system design perspective, renegotiating the two parties is a pre-procedure to minimise the judicial structure involved in the parties' autonomy. The author agrees with this view. According to the spirit of Chinese civil law and contract law, the legislative purpose of changing circumstances is not to promote the elimination of legal relations. It is to promote the solidity of contracts and strive to eliminate injustice to achieve the principles of fairness and honesty.

In contrast, the UK contract frustration system once attracted criticism because of the imperfect compensation system.

¹² *Walton Harvey Ltd v Walker & Homfrays Ltd* [1931] 1 Ch 274

¹³ *Walton Harvey Ltd v Walker & Homfrays Ltd* [1931] 1 Ch 274

¹⁴ Civil Code of the People's Republic of China, Article 533

¹⁵ Hengyu Zhou, 'Some Important Issues on the System of Circumstances Change in Civil Code' (2022) 6 *China Journal of Applied Jurisprudence* 194,208

In *Chandler v Webster*, the plaintiff leased a room to the defendant to view the king's coronation. The plaintiff paid 100 pounds on June 19. The remaining expenses shall be paid at the end of the ceremony according to the contract of both parties. The ceremony was then cancelled due to the king's illness. The plaintiff sued to recover the money he had paid. The defendant counterclaims that the plaintiff pays the remaining costs. The final court ruled that the plaintiff had no right to recover the paid fees and required the plaintiff to pay the remaining fees.¹⁶ (*Chandler v Webster* [1904] 1 KB 493)

The court held that the obligation to pay arose before the march was cancelled and that the plaintiff was obligated to pay the remaining costs even if the contract was frustrated. The ruling drew criticism because it violated the contract failure system's "frustration of purpose". The plaintiff had rented the room to watch the coronation and should have been relieved of the obligation to pay if the contract had been frustrated. In light of such arguments, UK law compensated for contract frustration. The Act provides: "All amounts payable under a contract are no longer payable, and any amounts paid are recoverable. If an expense is incurred, it can be deducted from the amount due or paid."¹⁷ (Law Reform (Frustrated Contracts) Act 1943, S.1 (2)) This provision makes the UK contract frustration system more perfect and embodies the principle of "frustration of purpose" and "failure to perform".

Although the English system of contract frustration has explicit legislation, judges are more likely to exercise their discretion in specific cases. Gradually establish and improve the legal system of contract frustration through precedents. Compared with the Chinese system of change of circumstances, this system of combining jurisprudence and legislation has the characteristics of greater flexibility, pertinence and robust operation. Moreover, there is some truth to Chinese changing circumstances regime. Compared with the UK, China is still a developing country. The UK economic market tends to be stable, and maintaining market stability is the primary goal of the contract frustration system. However, China is still in a period of rapid economic and market development and expansion. In this context, in addition to maintaining market stability and promoting economic development, encouraging more orderly signing of commercial contracts is also one of the purposes of the change of circumstances system. Therefore, the Chinese change of circumstances system gives the parties the right to renegotiate the contract and continue to maintain the validity of the contract.

6. Conclusion

This study compares the Chinese change of circumstances system and the UK contract frustration system. The theoretical basis, institutional content, judicial practice and legal consequences are compared successively. The two systems have similarities and differences at the same time. Both share similar theoretical foundations and legal objectives. However, there are significant differences in the system content, judicial practice and legal consequences. Compared with the UK, the Chinese system has a narrower jurisdiction. Among the legal consequences, the provision allowing the parties to negotiate greatly reflects the legislative characteristics of China in the period of rapid economic expansion. As an old capitalist power, the UK maintains market stability as its primary legislative pursuit. This paper argues that this is the most crucial reason for the institutional differences between China and the UK.

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¹⁷ Law Reform (Frustrated Contracts) Act 1943, S.1 (2)