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China's Judicial System and Judicial Reform

The following is an extract from the statement delivered by Michigan Law School Professor **Nicholas Howson** at the inaugural "China-U.S. Rule of Law Dialogue" held at Beijing's Tsinghua University July 29-30, 2010, and convened by Tsinghua Law Dean Wang Zhenmin and Harvard Law School Professor and East Asian Legal Studies Director William Alford, and with the support of the China-United States Exchange Foundation chaired by C.H. Tung, first chief executive and president of the Executive Council of the Hong Kong Special Administrative Region. The dialogue was organized as a private meeting between senior PRC law professors and U.S.-based Chinese law specialists to discuss China's three decades-long legal reform program and progress towards "rule of law" in the People's Republic of China in all areas of the domestic legal system.

Recently I have spent a significant amount of time studying Chinese People's Court judicial opinions in the corporate law and securities regulation areas, and have come across examples of extremely competent judicial work by the People's Courts at all levels. This in turn has pushed me to reconsider the goals and trajectory of "judicial reform" outside of the usual focus—the "vertical" social control/criminal law function—but still in the broader context of China's movement towards "rule of law" and a desired "rule of law state."

Admittedly, it is the judicial function in the social control/criminal law areas which attracts the most attention from Chinese and foreign legal scholars and journalists—*e.g.*, with respect to *judicial* constitutional review, administrative law and review, criminal law and criminal procedure, or mass torts that threaten to conjure group political action and social instability. That focus is entirely appropriate, for what we loosely understand as judicial independence (against superior political or military power) and the autonomy of the law (against political commands or shifting policy, and as contrasted with raw instrumentalism) must be at the core of anyone's conception of rule of law. At the same time, however, we must understand that the majority of the PRC citizenry intersects with law and legal institutions "horizontally" and at the apparently more mundane level of property and contracts rights and expectations.

As scholars intent on understanding the development of "rule of law" in contemporary China, we cannot therefore ignore entirely how legal institutions function, day to day, in the corporate/commercial/contract/property rights spheres, and most importantly how they are perceived to function by civil actors who have recourse to the same institutions for the settlement of disputes, clarification of property and contract rights, and enforcement of those rights—at least against other, horizontally positioned, actors. Indeed, many of the rights described and enforced in the commercial sphere—*e.g.*, residential and



COURTESY OF NICHOLAS HOWSON

Professor Howson addresses the Rule of Law Dialogue in Beijing, with Harvard Law Professor William Alford, the late Professor Betty Ho of the University of Toronto and Tsinghua University (and a former visiting scholar at Michigan Law), and Tsinghua Law School Dean Emeritus Wang Chenguang.

commercial real estate, intellectual property, labor contracting, family property, media and publication, etc.—may presently or in the future be asserted against institutions which have that present monopoly on political or coercive power. These claims may thus be seen as embryonic identities of the more sensitive civil and political rights understood to be at the core of "rule of law."

Let me be more concrete by citing two examples of what I think is highly competent adjudication in contemporary China, culled from publicly available judicial opinions. These examples, two among thousands, will never be described in the pages of *Nanfang Zhoumo* [Southern Weekend], *Caixin Magazine*, the *New York Times*, or *Le Monde*. Yet they reveal commendable judicial action that is relatively common, and distinct from the always fascinating stories of lack of judicial independence, official corruption, summary procedure, coercive use of the legal system and more that feature in the Chinese and foreign media.

A first case arose in Shanghai Municipality's relatively distant Baoshan District.¹ In the opinion, the Shanghai Baoshan District People's Court (later upheld by the Shanghai No. 2 Intermediate People's Court) looked through a *de jure* "corporate" establishment to understand a *de facto* "partnership" and to rule on the investing participants' rights accordingly. Disregarding form (and an

¹ *Zhang Qingzhao v. Zhang Wenhui*, Shanghai Baoshan District People's Court (2002); upheld on appeal Shanghai No. 2 Intermediate People's Court (2004). Reproduced in Supreme People's Court China Practical Jurisprudence Research Institute, ed., 55:1 RENMIN FAYUAN ANLI XUAN (2006), pp. 234-41.

apparent *Shareholders' Agreement* between the investors), the Baoshan court ruled that the entity at the center of the dispute was a kind of general partnership and ordered equal partner distributions of the enterprise's residual assets (instead of different proportions of the company's residual assets determined by the participants' notional "equity" investment). The Baoshan Court did not base its ruling on the imperfect PRC Partnership Enterprise Law or any other positive law, but what are understood to be universal partnership law principles: Unless subject to *ex ante* contract, partners share in the residual assets of the partnership equally, regardless of their investment or contribution to the partnership. This decision demonstrates a very high level of technical insight and competence, which even many U.S. state courts struggling to adjudicate close corporations might have had difficulty implementing.

A second case comes from the city of Zhengzhou in Henan Province,² where the shareholder of a property development company was permitted to initiate a derivative suit against a contractor that had not performed on a construction contract entered into with company. The problem in the case, for the initiating plaintiff at least, was that the complaining shareholder had not formally served the requisite demand on, or met with refusal from, the development company (the true party in interest in the derivative action) in conformity with Article 152 of China's 2006 Company Law. The defendant and non-performing construction contractor offered as one defense that "the plaintiff has not exhausted all internal remedies in accordance with legal stipulations," referring to the lack of required demand or refusal. However, both the Zhengzhou Municipal Guancheng Hui Minority District People's Court and the Zhengzhou Intermediate People's Court on appeal permitted the derivative action to go forward by taking judicial notice of that fact that originally the company *did* sue on the contract, but then withdrew its action (under the power, no doubt, of the breaching or simply conflicted fiduciary) at the time of the lower court proceedings. This allowed both courts to rule that (in the words of the appellate Intermediate People's Court opinion) "this may be seen as the same thing as a refusal [by the company] to bring the action." This elegant adjudication allowed the plaintiff and the courts to continue with the derivative action for contract enforcement even in the absence of legally required demand and refusal—a technical non-conformity which more timid or less autonomous courts would have invoked as a basis to deny the entire claim.

²*Lu Tong v. Henan Longxiang Construction Engineering Company Limited, In re: Henan Golden Mango Property Company Limited*, Zhengzhou Municipal Guancheng Hui Minority District People's Court (2007) *guan min er chu zi* No. 257; upheld on appeal Henan Provincial Zhengzhou Municipal Intermediate People's Court (2009) *zheng min er zhong zi* No. 718.

In these two cases we see something which might be considered extraordinary in the PRC context: technical competence certainly, but also the ability of Chinese judicial institutions to go beyond the bounds of formal statute in crafting a legal characterization and applying doctrine that vindicates important legal rights in a highly sophisticated and justice-facilitating way.

Tom Ginsburg and Timira Moustafa have identified five primary functions for judicial institutions in authoritarian political systems: (i) social control and the containment of political opposition; (ii) bolstering government "legitimacy"; (iii) support of administrative compliance and coordination of competing functions; (iv) facilitation of trade and investment; and (v) the provision of cover for controversial policies. I understand the Ginsburg-Moustafa list as somewhat partial and pessimistic. In fact, judicial institutions in non-democratic or authoritarian societies do much more than erect a Potemkin Village of purely symbolic decision-making and convenient cover for oppressive political organization. This is especially true as even *politically* unreconstructed societies experience *economic* system transformation, putting property and contract rights into the hands of low-level civil actors: contract parties, residential property owners, shareholders, inheritance beneficiaries, copyright owners, etc. One proof of this is the degree to which citizens in China with no particular political background, or assurance of a politically determined result, continue to refer to "law" and formal judicial institutions for remedies. We saw this in the strong appetite among individual shareholders for remedies against false or misleading disclosure in the securities markets between 1999 (after promulgation of the form of China's first Securities Law) and 2003 (when the Supreme People's Court permitted a limited private right of action against issuers, controlling shareholders, underwriters and accountants in such cases), and widely publicized cases discussed in the very independent PRC financial press. Aggrieved investors continued to push into the People's Courts, in many cases knowing that the defendants were actors with superior political and economic power in Chinese society (not to mention significant power over the judges in their locale). The fact that state institutions have sought to limit this recourse—for instance, by excluding claims against insider trading and securities manipulation, splitting large plaintiff groups into smaller groups, restricting contingency fee arrangements, or continuing to resist the introduction of the class action mechanism—does not dilute the certainty of *demand*-side interest in recourse to formal judicial institutions in contemporary China.

The critiques leveled against China's judicial institutions both in China and from abroad are many. These criticisms include: lack of technical competence; constrained political independence and the burden of Party Committees; funding of local level courts—and thus direct political control—by local level government (and Party) institutions; direction from adjudication committees; the inability

FACULTY VIEWS

to act against local government (Party) power to enforce civil rights and interests (not to mention *central* law or policy); relative powerlessness against the police, secret police and military; understaffing and over-stretched resources; procedural irregularities and confusion (including endless appeals and “black holes,” and failure to deliver resolution, compensation or any idea of “justice”); unrestrained and judgment-determining *ex parte* contacts; the continuing failure to hold public proceedings; corruption; lower courts seeking guidance from bureaucratically higher-level courts prior to decision; court officials working towards bureaucratic quota of “case handling” (case disposition) rather than substantive case-specific adjudication; refusal to accept cases that involve a large number of parties (triggering “social stability” [*shehui wending*] concerns); the drafting of opinions prior to submission of briefs or trial, or by court officials who have not attended case proceedings; enforcement “chaos” or impotence, etc. These specific concerns have only been augmented after 2007 by concern, again both Chinese and foreign, about a seeming shift in the rhetoric emanating from the Supreme People’s Court favoring a “democratic” (“masses”-friendly) judiciary, and attacking a “professional” (and “mystifying”) judicial apparatus.

The answers proposed—and in some cases implemented—to this collection of concerns tend to focus on mechanisms designed to enhance the People’s Courts’ technical competence, professionalism, transparency, procedural regularity, and political independence: (i) education, training, qualification and increased professionalization of judicial personnel; (ii) the uncoupling of local level courts from local governments and Party institutions, bureaucratically, politically and financially³ (with Supreme People’s Court officials advocating a federal court system with something like “diversity jurisdiction,” allowing for case acceptance and decision by disinterested judicial institutions); (iii) increased non-political oversight, and investigation and prosecution of corruption; and (iv) enhanced transparency in judicial action. As scholars of Chinese law and judicial institutions, we must be heartened by and approve of all of these measures. Indeed, they are measures taken by societies all over the world to strengthen the performance and legitimacy of the single most important institution necessary to deliver “rule of law.” There are of course historical and political complexities and obstacles specifically applicable to the huge and widely differentiated nation we call the “People’s Republic of

China” as it has developed to the end of the first decade of the second millennium. Those particular factors may counsel that we urge authentic and deeply rooted implementation of the above-listed reform measures *before* we push too hard for really extraordinary changes like *judicial* “strict” constitutional review,⁴ ever more robust judicial review of administrative action, and the like—favorites of Chinese legal reformers stretching back to the (mostly) Western-educated stalwarts of the early 20th century.

Yet even with those specific factors in mind, let me suggest one other idea for continuing development of China’s reforming judicial institutions, and one that is inspired by my close review of judicial opinions in the purely commercial sphere. It is an idea slightly divorced from what we legal specialists usually advocate, *i.e.*, substantive law reform, perfection of procedural rules, better financing of litigation or courts, etc. We should work to continue attracting “horizontal” dispute litigants into the PRC People’s Courts and attempt to remove obstacles, structural, substantive or applied, which keep those civil actors out of the courts, including the direction of cases to assuredly resource-efficient mediation, arbitration, or alternative dispute resolution. This proposed push has many virtues aside from those identified by institutional economists keen to show how predictably enforceable (and enforced) property rights result in economic development, and relates specifically to the task of constructing and reforming China’s judicial institutions. I am convinced that increased use of the People’s Courts in such cases would enhance the idea of such judicial institutions as the best and most authoritative forum for dispute resolution and property rights delineation (as opposed to China’s very strong pre-existing institutions such as local Party organizations, neighborhood committees, or family organizations). It would also serve the sometimes quite inchoate expectations of China’s population, who as noted above continue to look towards formal legal institutions for remedies, even against state or Party infringement of their rights and interests. But, and most importantly, increased traffic in the People’s Courts on complex matters with significant value at stake would give the courts themselves the chance to function, apply the law intelligently (and flexibly), demonstrate judicial independence, direct enforcement, and buttress their legitimacy as the critically important institution of a state governed “under law.” Of course, egregious mistakes will be made, corruption will continue to work its poison, and there will be vigorous resistance to increased judicial action from much stronger political forces. Yet China’s judicial institutions will be functioning, and seen to be functioning, with ever-increasing challenges to their competence, autonomy and political independence, and in an area of law and activity that does not impact directly on the political or social control sphere or the center of governance power. The hope is that if judicial institutions can establish themselves in this limited area, then their social power, effectiveness and legitimacy will extend to areas closer to the more sensitive core of what we perceive to be the “rule of law.”

Thank you very much.

³I note that the Politburo endorsed a proposal by the Central Political-Legal Committee to create central funding for all People’s Courts in November 2008 (see “Opinions of the Central Political-Legal Commission on Several Issues in the Deepening of Reform in the Judicial System and Work Mechanism”). This remains unimplemented as of this statement.

⁴My idea of “strict” constitutional review is review, by a court or independent commission, of the conformity of legislative acts and executive action with superior norms laid out in a Constitution. At the present time this kind of review is not permitted under the PRC Constitution of 1982 (as amended), although it is allowed, in limited circumstances, under the Basic Law of the Hong Kong Special Administrative Region, *i.e.*, with respect to Hong Kong SAR legislative norms that do not relate to the concerns of the Central People’s Government or the relationship between the Central People’s Government and the Hong Kong SAR. Of course, administrative review has been a reality in the PRC since the promulgation of the 1989 Administrative Litigation Law.



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Progress and Pitfalls: Trade and Investment Relations with China at Heart of Conference

A conference co-organized by the U-M Law School earlier this year brought together a prominent contingent of experts on trade relations and cross-border investment between the United States and China who emphasized the opportunities and potential conflicts as China rises to a global trade and investment power.

During a keynote address, Ambassador Charlene Barshefsky, President Clinton's U.S. Trade Representative (USTR) and the person who negotiated China's accession to the World Trade Organization spoke of increased head-to-head competition between developed and developing countries generally, business conditions in China that often are disadvantageous for foreign companies, and a change in the global trade and capital markets from U.S. dominance to a marked increase in China's power and influence.

"The re-emergence of China . . . will be the biggest economic story of this century, in my opinion," she said. "It is both a cause for marvel and a cause for significant global concern."

The event, as conceived by U-M Law Professor Nicholas C. Howson and Wayne State University Law Professor Julia Qin, featured a public dialogue between the world's top academic experts on trade relations between the United States and the People's Republic of China, present and former government officials from Beijing and Washington who have been tasked with negotiating and implementing that important relationship, and the legal professionals who represent the two nations (and in some cases domestic petitioning groups) in actual disputes.

One goal of the conference "was to focus the same high-powered analysis and discussion on other aspects of the economic relationship, including of course investment (going both ways) and broader systemic concerns like the economics of international trade and investment, climate change, the demands of the energy industry, the rise of the Chinese currency, and domestic judicial and enforcement institutions in both nations," Howson noted.

Howson said he and Qin were pleased to have gathered some of the key figures involved in the U.S.-China relationship, including: Ambassador Barshefsky; Madame Li Yongjie, the Chinese Ministry of Commerce official in charge of all WTO disputes and resulting litigation; Tim Stratford, a former director of the China Desk at the U.S. Trade Representative; and Professor Merit Janow, who recently stepped down from the WTO's Supreme Court equivalent, the Appellate Body.

In addition to Professor Howson, U-M Law School also was represented by Professor Edward Parson, who described the present state of U.S.-China climate change negotiations. Other U-M participants included Professor Mary Gallagher, director of the U-M Center for Chinese Studies; Professor Zhao Minyuan of the Ross Business School; and Professor Alan Deardorff of the U-M Economics Department, who also serves as the associate dean of the Ford Public Policy School.