

The Relationship between Interest and liquidated Damages in Construction Contracts

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Abstract

There are certain differences in practice regarding whether the contractor of a construction project construction contract can claim both the contractual or statutory interest and liquidated damages from the employer. From the origin and essence of interest, it can be known that it is a part of the "proceeds" obtained by the lender according to the contract. As long as the delayed payment behavior exists, interest becomes the property that the right holder will inevitably lose. The consequences of the aforementioned "loss" have a direct causal relationship with the debtor's breach of contract and there is no difference due to the construction project or contract. As far as liquidated damages are concerned, they are also a form of liability for breach of contract, with the main purpose of compensating for the losses of the observant party. It is not inappropriate to classify the interest lost by the right holder as a loss under the scope of liability for breach of contract. The basic legal relationship between the employer and the contractor arising from the construction of the project is a contract of contract, not a loan contract. As for the outstanding project funds of the employer, it undoubtedly belongs to the category of overdue payments that are payable but not paid.

Keywords: construction project, contract interest, penalty overdue, payment

As far as the word interest is concerned, it belongs to the concept of economics. The soil of "interest" is based on the long history of the lending relationship, and its essence is to compensate creditors for the loss caused by the loss of money control and liquidity opportunities.

In traditional civil law theory, fruits are generally divided into natural fruits and legal fruits. Natural fruit refers to the fruit produced from the original according to the law of nature; Legal fruits refer to the fruits derived from the original property by performing certain legal acts on the original property, such as rent, interest, etc. Specific to the legal norm of our country, the fructus concept has appeared many times, but the fructus itself does not give a definition for the specific meanings. Specifically, Article 17 of the Interpretation of the Supreme People's Court on the Application of Law to the trial of Disputes concerning construction Contracts of construction Projects (hereinafter referred to as the Judicial Interpretation of Construction Projects) stipulates that "if the parties have an agreement on the payment standard of interest owed from the project price, it shall be handled in accordance with the agreement; In the absence of such an agreement, the interest rate shall be calculated according to the rate of similar loans issued by the People's Bank of China for the same period." As for the nature of the above "interest", there has been a dispute in the process of the introduction of this article. One point of view is that the interest on project arrears is not the fruits of the project money, which belongs to the way to bear the liability for breach of contract. Another view that the nature of the unpaid project interest is legal fruits, rather than liquidated damages; Judicial interpretation ultimately adopted the latter view.

For liquidated damages, it refers to a sum of money or other payment to the other party when one party fails to perform or fails to fully perform the contract agreed by the parties or stipulated by law. Article 114 (1) of the Contract Law stipulates: "The parties may agree that if one party breaches the contract, it shall pay a certain amount of liquidated damages to the other party according to the circumstances of the breach, and may also agree on the calculation method of the amount of damages resulting from the breach." For the nature of the above liquidated damages, in accordance with the theoretical and practical circles, it should be based on compensatory, punitive supplement. Since it is mainly compensatory, the basis of compensation should be based on the objective loss suffered by the non-breaching party, so the party also enjoys the right to request the court to

adjust the liquidated damages.

Combined with the analysis of the above concepts, we can know that: Interest is essentially the economic concept, the fruits belong to the law, according to the majority view of the theoretical circles in our country, the fruits interest is one of the legal fruits, although there is the appearance of the interest, but as far as civil subjects other than financial institutions are concerned, how much interest usually depends on the parties' meaning autonomy, but the legal norm sets a limit for it. As far as interest and liquidated damages are concerned, although there are differences in their conceptual connotations, there is also no lack of crossover. For example, interest can become a way to determine liquidated damages or the scope of liquidated damages can include interest. Therefore, from this point of view, there is no either-or exclusion relationship between interest and liquidated damages.

1. Sorting Out: Interest Standard and Its Practical Disputes with Liquidated Damages Relationship

Based on Article 17 of the Judicial Interpretation of Construction Projects, there are often disputes in practice as follows: First, can interest and liquidated damages be supported by the court at the same time? Second, how to determine the calculation standard of interest? In this regard, there are differences in the handling methods of different courts. The representative views are summarized as follows.

1.1 The Disputed Views on the Relationship Between the Application of Interest and Liquidated Damages

As for whether interest and liquidated damages can be supported by the court at the same time, taking the normative documents of local high courts as an example, there are mainly three handling methods as follows.

Support classes simultaneously. That is, when the contractor advocates liquidated damages and interest together in litigation, in principle, it can be supported at the same time. This view is represented by Anhui Province. Article 16 of the Guiding Opinions of Anhui High People's Court on the Application of Law to the Trial of Cases concerning Disputes over construction Contracts of Construction Projects (II) stipulates: "If the parties claim liquidated damages and interest at the same time, support may be given. If the total amount claimed by the parties is within the range of 4 times the interest rate of the same kind of loan or the basic interest rate of the loan published by the People's Bank of China for the same period, it shall be determined based on factors such as the circumstances and extent of the breach and the amount of losses caused to the non-breaching party. If the total amount claimed by the party exceeds the range of 4 times the interest rate of the same loan or the basic interest rate of the loan for the same period published by the People's Bank of China, it shall prove the actual amount of loss, and the people's court shall handle the matter in accordance with Article 29 of the Interpretation of the Supreme People's Court on Some Issues Concerning the Application of the Contract Law of the People's Republic of China (II)."

convention priority + select support. Whether the parties can claim liquidated damages and interest at the same time, first of all, it needs to examine the contract agreement, if there is an agreement, it can claim at the same time, if there is no agreement, in principle, it can only choose one of the propositions. This view is epitomised by Beijing. According to Article 36 of the Beijing Municipal High People's Court on the Trial of Several Difficult Issues in the Dispute over the Construction Contract of Construction Projects: "If the contract for construction projects clearly stipulates that the owner delays in paying the project money, and the contractor may simultaneously claim for overdue payment of liquidated damages and interest, in accordance with the contract, if the owner claims that the sum of the liquidated damages and interest agreed in the contract is too much higher than the actual loss, the case shall be handled in accordance with Article 29 of Interpretation of Contract Law II. If there is no agreement or unclear agreement, the contractor's claims shall not be supported at the same time, unless the contractor has evidence to prove that the liquidated damages or interest agreed in the contract alone is insufficient to cover his actual losses."

Select support classes. That is, the parties can not claim liquidated damages and interest at the same time, and can only choose one. This view is represented by Zhejiang Province, "the First Court of Civil Trial of Zhejiang Province High People's Court on the trial of construction contract dispute cases of several difficult issues" Article 21 stipulates that "the contractor can not in accordance with the construction contract, not only request the contractor to bear the overdue payment of the project payment of liquidated damages, but also request the payment of the corresponding interest".

1.2 Disputed Views on the Standard of Interest Calculation

As for the calculation standard of interest, in accordance with the provisions of Article 17 of the Judicial Interpretation on Construction Projects, if the parties have an agreement, the agreement shall be followed; if there is no agreement, the interest shall be calculated according to the interest rate of similar loans issued by the

People's Bank of China for the same period. From the text analysis, its interest cap is not limited. However, in the Understanding and Application of Judicial Interpretation of the Construction Contract of the Supreme People's Court, its analytical content includes: "Since the nature of the interest owed for the construction price is legal fruits, the interest rate agreed in the contract should be protected only within the upper and lower limits of the national legal interest rate... Why can't interest be charged above the legal rate with or without agreement? The legal interest rate is also called the benchmark interest rate, which is issued by the People's Bank of China." The logical conclusion is that even if there is an agreement between the parties, the interest rate should not exceed the benchmark interest rate issued by the People's Bank of China for the same period.

However, Article 6 of Several Opinions of the Supreme People's Court on the Trial of Credit and Loan Cases by the People's Court (Famin [1991] No.21, hereinafter referred to as Several Opinions on Credit and Loan Cases), which was still in force at the same time, stipulates: "The interest rate of private loans may be appropriately higher than that of banks, and the local people's courts may determine it in accordance with the actual conditions of their respective regions, but the maximum shall not exceed four times the interest rate of similar loans of banks (including the principal amount of the interest rate). If the interest rate exceeds this limit, the interest on the excess part shall not be protected." In September 2015, the Provisions of the Supreme People's Court on Several Issues concerning the Application of Law to the Trial of Private Lending Cases (Legal Interpretation [2015] No. 18, hereinafter referred to as "Provisions on Private Lending") came into effect, which changed the interest rate standard in private lending. The first paragraph of Article 26 stipulates: "Where the interest rate agreed upon by the two parties does not exceed 24% of the annual interest rate, and the lender requests the borrower to pay the interest at the agreed interest rate, the people's Court shall support it."

With the above judicial interpretation related to interest rate as the background, it can be found that the courts in many places did not limit the interest rate to the benchmark interest rate of the People's Bank of China, but referred to the private lending interest rate of the same period, and roughly formed the following two opinions.

Distinguish between agreed and unagreed interest standards. According to the principle of Article 17 of the Judicial Interpretation of Construction Engineering, some courts have distinguished the two cases of agreement and non-agreement for the calculation of interest standards, but in terms of standard determination, they have broken through the provisions of the judicial interpretation above. For example, Article 11 of the "Answers to Several Questions of Jiangsu Provincial High People's Court on Hearing Cases Concerning Construction Contract Disputes" issued in June 2018 stipulates that: "If the parties have agreed on the calculation standard for the interest of the unpaid project price, it shall be handled according to the agreement, but the annual interest rate shall not exceed 24%. If there is no agreement, refer to the Interpretation of the Supreme People's Court on the Application of legal issues in the trial of Disputes over sales Contracts (Interpretation [2012] No.8, hereinafter referred to as the Interpretation of Sales Contract Disputes), Article 24, paragraph 4, can be calculated based on the benchmark interest rate of similar RMB loans of the People's Bank of China for the same period, and refer to the interest rate standard of overdue penalty interest.

No distinction between the agreed and non-agreed interest standard. As represented by Article 26 of the Guiding Opinions of Anhui High People's Court on the Application of Law to the Trial of Construction Contract Dispute Cases (II) mentioned above, some district courts do not strictly distinguish between agreed and unagreed situations. Instead, it broadly defined the upper limit of interest that parties can claim within the range of 4 times the interest rate of similar loans published by the People's Bank of China.

2. Interpretation: The Nature of Interest and Unpaid in the Judicial Interpretation of Construction Projects

2.1 Determination of the Nature of Interest and Coverage of Liability for Breach of Contract

For the nature of interest, the above has been discussed, so no matter in any context, the connotation of interest should be determined and should not be confused with the meaning of liquidated damages. The reason lies in the difference of concept and nature, which will directly determine the legal norms which should be restricted. Specifically speaking, in the current legal context of our country, interest does have to be directly restricted by "private lending regulations" except for financial institutions; The judgment of liquidated damages is mainly restricted by the Contract Law and related judicial interpretation. If the connotation of interest and liquidated damages is blurred, it may lead to confusion in the application of law.

While there is disagreement about the meaning of fructus and legal fructus, it is useful to move away from conceptual arguments for a moment and towards more pragmatic problem-solving. Set aside the dispute, even if the interest is defined as a legal fruit, does this mean that the interest and the liability for breach of contract belong to the inseparable boundary? I fear not. Specifically, from the origin and nature of interest, it can be

known that it is a part of the "income" obtained by the lender according to the contract. If it involves other non-lending contracts, such as sales and construction contracts, in the exchange of rights and obligations, as long as one party is idle in performing the payment obligation, the right holder will also lose the possession and flow of money, thus resulting in the loss of interest. From this perspective, it can be found that as long as the delay in payment exists, the interest will become the property that the right holder will inevitably lose. The consequences of the above "loss" have a direct causal relationship with the debtor's breach of contract, and there is no difference due to the construction project or contract of employment. Article 107 of the Contract Law stipulates: "If a party fails to perform the contractual obligations or the performance of the contractual obligations is not in conformity with the agreement, it shall bear the liabilities for breach of contract, such as continuing to perform the contractual obligations, taking remedial measures or making compensation for losses." At this time, it is not inappropriate to include the interest lost by the right holder as the loss in the category of liability for breach of contract. In addition, in terms of liquidated damages, of course, it is also a form of liability for breach of contract, the main purpose is to make up for the loss of the observant.

Thus it can be seen that the dispute result of whether interest is legal fruits will not affect the category of default liability.

2.2 Normative Continuation of Overdue Repayment and Overdue Payment

Overdue repayment and overdue payment, although a word difference, but the basic legal relationship they rely on is different. The so-called "repayment" depends on the premise of "lending money", which is the legal relationship of the loan contract; The so-called "payment" depends on the premise of "exchange of equivalent goods", which should be the legal relationship of the sale, contract and other contracts. For the overdue repayment and overdue payment of the "price", our legal norms have generally maintained a more consistent treatment.

Rules for late repayment. Article 9 of Several Opinions on Lending Cases issued in 1991 stipulates: "For regular interest-free loans between citizens, where the lender requires the borrower to pay overdue interest, or for non-regular interest-free loans that are not paid after being urged to return, the lender requires to pay the interest after being urged to pay interest, the interest can be calculated with reference to the interest rate of similar loans in banks."

In 2011, the Notice of the Supreme People's Court on Properly Hearing Civil Lending Dispute Cases in accordance with the Law to Promote Economic Development and Maintain Social Stability clearly stated: "Where the parties fail to agree on neither the internal interest rate nor the overdue interest rate, the lender shall support the interest loss from the overdue repayment date by referring to the benchmark interest rate of similar loans of the People's Bank of China for the same period."

In 2015, Article 29 of the Regulations on Private Lending states: "... (1) Where neither the interest rate of the loan period nor the interest rate of the loan period is prescribed, and where the lender claims that the borrower shall pay the interest of the period occupied by the funds at an annual interest rate of 6% from the date of overdue repayment, the people's court shall support it; ..." . As for the origin of the above 6%, the interpretation and Application of Judicial Interpretation of Private Lending by the Supreme People's Court explains that: "According to the situation that the one-year benchmark lending rate issued by the People's Bank of China is roughly 6% in recent years, considering that there are many kinds of interest rates of similar loans in the same period and the calculation is complicated, in order to unify the judgment standard, this article stipulates that the annual interest rate should be calculated as 6%."

From the above analysis, we can see that for overdue repayment, China's relevant laws and regulations maintain the same idea: referring to the People's Bank of China's similar loan interest rate in the same period, there is no "penalty interest" attached.

Rules for late payment. In 1999, the Reply of the Supreme People's Court on the Issue of the Standard for the calculation of Liquidated damages for overdue Payment (Interpretation [1999] No. 8) stipulated: "If the parties to the contract do not agree on the standard for liquidated damages for overdue payment, the People's Court may calculate the liquidated damages for overdue payment by referring to the standard for the collection of overdue loan interest of financial institutions stipulated by the People's Bank of China. Where the People's Bank of China adjusts the standards for calculating interest on overdue loans of a financial institution, the people's court may adjust the standards for calculating liquidated damages for overdue payments accordingly. According to the provisions of the Notice on Lowering the Deposit and Loan Interest Rates of Financial Institutions issued by the People's Bank of China on April 30, 1996, Yinfa [1996] No. 156, currently, the penalty for late payment can be calculated at 4 ‰ per day." In 2000, The Reply of the Supreme People's Court on the Amendment of the Reply

of the Supreme People's Court on the Question of the Standard for the Calculation of Liquidated Damages for Overdue Payment (Interpretation [2000] No. 34) deleted the above provisions "referring to the Notice on Lowering the Deposit and Loan Interest Rates of Financial Institutions issued by the People's Bank of China on April 30, 1996 (Yinfa (1996) No. 156) Set, at present, late payment penalty standard can be calculated by four thousand per day "content.

Article 17 of the Interpretation of the Supreme People's Court on Several Issues concerning the Application of Law to the Trial of Disputes concerning the Sale Contract of commercial Housing (Interpretation [2003] No. 7) in 2003 stipulates: "The sale contract of commercial housing does not specify the amount of liquidated damages or the calculation method of the amount of loss compensation. The amount of liquidated damages or the amount of loss compensation can be determined by referring to the following standards: If the payment is overdue, it shall be calculated on the basis of the total amount of unpaid house purchase and with reference to the standard for calculating overdue loan interest set by financial institutions stipulated by the People's Bank of China."

Article 24 (4) of the Interpretation of Sales Contract Disputes in 2012 stipulates: "The sales contract does not stipulate the liquidated damages for overdue payment or the calculation method of such liquidated damages, and if the seller claims to compensate for the loss of overdue payment on the grounds of the buyer's breach of contract, the people's court may calculate the penalty interest rate for overdue payment based on the benchmark interest rate of similar RMB loans of the People's Bank of China in the same period."

It can be seen that although relevant judicial interpretations have changed due to the adjustment of overdue loan interest rate by the People's Bank of China, the standard of "penalty interest" attached to the loan interest rate is adhered to in principle for the consequences of overdue payment.

On the basis of the above analysis, then observe the meaning of "unpaid project price" in Article 17 of Judicial Interpretation of Construction Engineering. Obviously, the basic legal relationship between the owner and the contractor due to the construction of the project is a contract of employment, rather than a loan contract. In terms of the project money "owed" by the owner, it undoubtedly belongs to the category of "overdue payment" which is payable but not paid.

3. Rules: The Actual Selection and Appropriate Way of the Current Norms

For the two controversial issues in the above practice, combining with the current legal norms and the above analysis, the adjudication rules should be gradually clear.

3.1 Rules for Judging Liquidated Damages and Interest

The reason why interest and liquidated damages form many entanglements in practice is related to the model text of the construction contract of the construction project in addition to the legal fruits and the dispute over the liability for breach of contract. Article 33 of the general terms of the 1999 version of the Construction Contract (Model Text) shows: "If the developer fails to pay the completion settlement price within 28 days after receiving the completion settlement report and settlement data without any valid reasons, the contractor shall pay the interest in arrears of the project price according to the loan rate to the bank from the 29th day, and bear the liability for breach of contract." This makes a lot of interest and liquidated damages coexist disputes appear. However, in the 2013 version of the model text, this content has changed greatly. In the 2013 version of the model text, it is stated in Clause 2 of Article 14.2: "Unless otherwise agreed in the special contract terms, the owner shall complete the payment to the contractor within 14 days after the issuance of the payment for completion certificate. If the developer delays the payment, it shall pay a penalty according to the benchmark interest rate of the same kind of loans for the same period published by the People's Bank of China; if the payment is overdue for more than 56 days, it shall pay a penalty according to twice the benchmark interest rate of the same kind of loans for the same period published by the People's Bank of China." It can be seen that the interest and liquidated damages (liability for breach of contract) are no longer used as the concept of parallel, and the interest calculated according to the interest rate as liquidated damages. The latest 2017 model text also retains the above provisions. Of course, from another point of view, the appearance of the above amendment clause cannot completely ignore the influence of judicial treatment on it.

Based on the above analysis and the modification of the construction project model text, it can be seen that both liquidated damages and interest can be included in the scope of liability for breach of contract, with the main purpose of making up for the losses of the non-breaching party. According to Article 114 of the Contract Law, the parties may agree on a certain amount of liquidated damages for the consequences of breach of contract, and may also agree on the calculation method of the amount of damages. Therefore, the interest rate agreed by the parties in the contract shall be the method of calculating the compensation for the loss of interest provided that

the interest is the contractor's natural loss. However, the contractor can still cause other losses because of the owner's breach of contract, at this time according to the "filling" principle of liquidated damages adjustment, creditors can certainly enjoy the right to claim liquidated damages at the same time, simply from the procedural negation of interest and liquidated damages together does not exist a solid theoretical basis, also contrary to the practical needs.

In terms of the existence of interest and liquidated damages in the construction contract, it can be roughly divided into the following three kinds: first, the parties agree on liquidated damages and interest in the contract, and clearly can claim at the same time; Second, the parties agreed in the contract liquidated damages and interest, not clear whether can claim at the same time; Third, the parties only agree on interest or liquidated damages in the contract.

For the first and second cases above, as mentioned above, interest belongs to the inevitable losses of the parties, so it should be supported. As for the standard interest rate, it should be limited to 24% based on the Regulations on Private Lending. Whether liquidated damages can be supported at the same time depends on whether other losses are caused to the contractor by the owner's delay in payment. If so, liquidated damages shall be appropriately determined and adjusted according to the loss situation and in combination with the provisions of Article 29 of Interpretation of Contract Law II. However, it remains to be noted that if the interest agreed by the parties is higher than 24%, and there is no liquidated damages clause, and the contractor actually suffers more losses than the above agreed interest, can it directly support the "high" interest? The author believes that, under the premise of determining the meaning of interest, the limit range of "Regulations on Private lending" should be strictly followed to ensure the unity of legal cohesion. As for additional losses, they may be determined by means of compensation for losses.

For the third case, if only liquidated damages are stipulated in the contract, it is necessary to determine whether to adjust liquidated damages based on "interest losses" and other losses in accordance with the provisions of the Contract Law. It is not necessary to list interest in a separate item. If only the interest is agreed in the contract, and the contractor suffers more losses than the agreed interest due to the owner's breach of contract, he may request the owner to compensate for other losses, but this time is not in the name of "liquidated damages".

However, it should be noted that the above discussion on liquidated damages and interest rules should be limited to one premise: that is, only for the late payment behavior of construction contracts. On the contrary, if the construction contract of the construction project provides interest for late payment and liquidated damages for other breaches of contract, in the subsequent performance process, if the owner has multiple breaches of contract, support should be taken as the basic principle. Specifically, late payment behavior leads to the inevitable occurrence of interest loss, so it should be supported; For other breaches of contract of the owner, even if the contractor does not suffer any loss, the owner should also pay the price. Its basic legal principle lies not only in the principle of good faith, but also in the fact that the liquidated damages stipulated in the Contract Law are punitive in addition to compensation. As for the standard for determining liquidated damages in the above cases, the author believes that we can refer to the provisions of Article 29 of Interpretation of Contract Law II, take the interest within the agreed legal limit as the basis of loss, and only adjust the amount exceeding 30% of the above loss.

3.2 Rules for Adjudication of Unpaid Interest on Project Funds

If the parties do not agree on the payment standard of the overdue project interest, how to deal with it? The answer to this question involves two considerations. First, from a practical point of view, Article 17 of the current Judicial Interpretation on Construction Engineering has given a clear answer, that is, the interest rate of the same type of loan issued by the People's Bank of China should be calculated. Of course, according to the current bank financial policy, it is more appropriate to express it as "the benchmark rate of the same type of RMB loan for the same period". Secondly, from the perspective of necessity, according to the above mentioned, the behavior of overdue payment of project funds belongs to overdue payment. From the analysis of the continuity of Chinese legal norms, the developer needs to bear not only the benchmark interest rate of similar loans at the same time, but also a certain overdue "penalty interest". The reason is that if the cost of overdue payment is lower than or equal to the cost of obtaining financing through normal loan channels, it will objectively prompt the employer to have the impulse of malicious default on payment based on the consideration of interests. Therefore, from the perspective of necessity, it is more appropriate to determine the rules of the payment standard for the unpaid project interest as follows: based on the benchmark interest rate of similar RMB loans of the People's Bank of China in the same period, and calculated with reference to the interest rate standard of overdue penalty interest.

3.3 Interest Shall Not Fall Within the Scope of Priority

On the basis of the above analysis, another hot issue in practice, that is, whether interest belongs to the scope of priority compensation right of construction project price, also tends to be clear.

Although the views of the Supreme Court on this issue vary from place to place, even in the opinion that the interest is the priority to be repaid, the basis for it is not stated or only stated that the reason is legal fruits. However, as mentioned above, no matter whether interest is defined as legal fruits, its essence is still the loss caused by the parties' breach of contract, and there is no definite and inevitable theoretical and normative connection between the concept of legal fruits and the scope of preferential compensation. According to the provisions of the Reply of the Supreme People's Court on the priority of compensation of the Construction Project Price (Interpretation [2002] No. 16), the construction project price includes the actual expenses paid by the contractor for the construction project, such as the remuneration of the staff and the payment of materials, excluding the losses caused by the contractor due to the breach of contract by the owner. It follows that interest is not a priority.

On the contrary, if the interest is regarded as the category of priority right to receive compensation, it means that the parties will no longer have realistic "selectivity" between interest and liquidated damages, because at this time, the interest has a unique priority status, which is separated from the field of ordinary creditor's rights to some extent, and has a certain degree of "real right" nature, and then the consequences are as follows: The scope of the contractor's priority may vary even in the face of the same construction price, because the scope depends to some extent not only on the autonomy of the parties' agreement on the interest arising from the breach, but also on the amount agreed. This not only violates the spirit of the above-mentioned approval, but also undermines the certainty of the legal identity of the priority right to compensation.

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