A COMPARATIVE ANALYSIS OF THE FOREIGN ECONOMIC CONTRACT LAW OF THE PEOPLE'S REPUBLIC OF CHINA

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The Foreign Economic Contract Law of the People's Republic of China (FECL), promulgated on March 21, 1985,[1] marks an important stage in the development of the legal system of the People's Republic of China (PRC). It is one of the few comprehensive pieces of foreign economic legislation in China, covering virtually all foreign commercial activities ranging from finance and trade to service and investment.[2] Since contracts have been the most important legal forms for China's international commercial exchanges,[3] the

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1. Foreign Economic Contract Law of the People's Republic of China (adopted and promulgated March 21, 1985; effective July 1, 1985), *reprinted in* People's Daily, March 22, 1985, at 2 [hereinafter cited as FECL]. Unless otherwise indicated, all People's Daily citations are to the overseas edition of this official Chinese language newspaper.

2. The FECL applies to all economic contracts between Chinese enterprises and foreign businesses or individuals, except for contracts concerning international transportation. *Id.* art. 2.

3. Contracts have been used for all kinds of commercial exchanges with foreign nationals. In the foreign investment area alone, China has concluded more than 7,000 contracts involving investment projects since 1979. *See China Business Briefs,* Asian Wall St. J. Weekly, Dec. 2, 1985, at 11. This is only a small fraction of the total number of foreign economic contracts negotiated by Chinese businesses in the same period. According to an official publication, these investment contracts, together with many other forms of contract other than those on international sales, make up less than one third of China's total foreign economic contracts. More than two thirds of China's foreign economic contracts concern international sales. *See* Shen Hong, Vice Chairman of the Legal Committee of the National People's Congress of the People's Republic of China, *Report on the Foreign Economic Contract Law of the People's Republic of China,* given to the Tenth Session of the Standing Committee of the Sixth National People's Congress (news release of Xinhua News Agency, Mar. 16, 1986).

FECL has naturally become the focus of China's foreign economic legal structure. The following introduction to the FECL utilizes primarily a comparative analysis. Chapter 1 describes briefly the development of contract law in the PRC. Chapter 2 generally introduces the FECL in relation to other relevant Chinese foreign economic legislation, and explains how the FECL fits in with China's foreign economic legal framework. Chapter 3 analyzes major elements of the FECL and compares them to Anglo-American common law in the hope of providing a better understanding of the FECL to those familiar with common law contract principles.

I. HISTORICAL DEVELOPMENT OF CHINA'S CONTRACT LAW AND THE CREATION OF THE FECL

The FECL represents an important stage in the development of China's contract law. The earliest contract law in the PRC emerged in September 1950 in a pronouncement by the Financial and Economic Committee of the then Council for Government Affairs, the forerunner of the State Council.[4] The regulation, entitled "Interim Rules Regarding Contracts among Government Organizations, State-owned Enterprises and Collective Units", contained the basic principles and framework of the current domestic Economic Contract Law.[5] However, unlike the Economic Contract Law, the

4. Q. LAN, THIRTY YEARS OF LEGAL DEVELOPMENT IN THE PEOPLE'S REPUBLIC OF CHINA 83 (1982) (Chinese ed.).

5. The import of the Interim Rules is basically as follows:

> (i) They mandate that certain economic activities be regulated by contracts. Economic transactions that fall within this category include: loans, sales of goods, barters, orders for manufacturing, consignments for collection or payment of loans or leases, transportation, leases, joint ventures, construction, etc.
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> (ii) They require that bank loans must be backed up by guarantees and collateral. For those loans based on the state plan with no collateral attached, the responsible authority acts as a guarantor. Other contracts must be guaranteed by the authority over the parties to the contract. Contracts must be signed in the name of a juristic person, and personnel changes within an enterprise should not affect the validity of the contract. A guarantee must also be in the name of a juristic person.
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> (iii) They require that contracts be performed once lawfully concluded. Any revision shall be based on an agreement of the parties and the guarantor. Default in performance results in liability of the breaching party. A guarantor is jointly and severally liable.
>
> (iv) They require that litigation with respect to contracts be heard by the relevant Commission on Finance and Economy of the government of the region where litigants reside. Parties unable to accept the decision of the Commission may bring suit in court.

Id.

In accordance with the Interim Rules, other departments of the central government have also promulgated special rules for contracts such as contracts for construction, loans, leases, manufacturing and processing, etc.

The Economic Contract Law of 1982 contains a basic structure and principles sub-

regulation did not emphasize the State plan.[6] The regulation was largely ignored during the later 1950's as the "Great Leap Forward" wiped out virtually every established economic rule.

In the early 1960's as the economic and political situation was gradually stabilizing, the National Economic Committee issued on August 30, 1963 the "Interim Regulation on Contracts for Ordering Industrial and Mineral Products", which imposed economic sanctions on parties unable to fulfill contractual obligations.[7] To further emphasize the role of contract in the economy and to reinforce the new rules, the Communist Party Central Committee and the State Council in December 1963 jointly issued the "Pronouncement Regarding Strictly Implementing Economic Contracts", reaffirming the principles of the early contract regulations.[8]

The Cultural Revolution, from 1966 to 1976, significantly undermined China's legal system, as well as its limited contract law. In the post-Mao period, as the new economic policy begins to take shape, the role of contract is once again being emphasized. In 1978 and 1979, various governmental agencies promulgated interim rules and regulations to fill the legal void in the contract area.[9] Simultaneously, the drafting of an economic contract law was widely discussed within the Chinese legal community. In 1981 the Economic Contract Law of the People's Republic of China (ECL) was enacted and a formal contract law came into being.[10]

The law relating to foreign economic contracts was not for-

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stantially similar to those set up in the Interim Rules. The Economic Contract Law of the People's Republic of China, adopted at the 4th Session of the 5th National People's Congress on Dec. 13, 1981, *reprinted in* 2 CHINA L. REP. 61 (1982) [hereinafter cited as ECL].

6. This conformed to the special political and economic situation in China in the early 1950's, at which time private enterprises had not been nationalized, state-controlled enterprises had not reached an overwhelmingly dominant position in the economy, and the economic transactions between private and state-owned enterprises were largely regulated by market rules.

7. Q. LAN, *supra* note 4, at 85.

8. "Every enterprise of the national economy must strictly follow economic contracts. Manufacturers must conduct production in accordance with the requirements of their contracts, guaranteeing the quality of the products and the time of delivery. Purchasers must accept delivery and make payment on time." *Id.* at 84.

The pronouncement also orders other government departments to make specific implementing rules ensuring strict performance of economic contracts. *Id.*

9. These rules and regulations include a regulation by the national Goods and Materials Bureau, and a joint pronouncement by the State Economic Committee, the Bureau for Industry and Commerce Administration, and the People's Bank of China. *See* ECONOMIC LAWS AND REGULATIONS RESEARCH CENTER OF THE STATE COUNCIL, SELECTED ECONOMIC CONTRACT LAWS AND REGULATIONS *passim* (1982) (Chinese ed.).

10. For the development of China's legal system, including contract laws since the Cultural Revolution, see generally Foster, *Codification in Post-Mao China,* 30 AM. J. COMP. L. 395 (1982); Kato, *Civil and Economic Law in the People's Republic of China,* 30 AM. J. COMP. L. 429 (1982).

mally codified until the 1980's. For over thirty years China maintained trade and other economic relations with many countries, regulated largely by established international practice. In the area of foreign economic relations China has implicitly shared many of the contract principles and practices of the world trading community.[11] From international economic exchanges, far more numerous in recent years due to the Chinese "open-door" policy, China has gradually developed its own "common law" based on its experience of dealing with foreign business and international commercial customs.[12] In the field of foreign economic contract law, these rules are embodied in a variety of model contracts used by Chinese entities as a basis for negotiations with foreign counterparts.[13] However, foreign business people found these model contracts as well as the unwritten international commercial practice implicitly accepted by the Chinese to be inadequate. Even when the Sino-foreign commercial exchanges were less extensive, foreign companies were sometimes frustrated by the lack of law for concluding contracts and resolving contract disputes.[14] As the post-Mao open-door policy brought about an unprecedented increase in the extent and complexity of China's foreign economic relations, lack of legal certainty and stability became the major obstacle to further development of Sino-foreign commercial relations. The Chinese government also realized that the enactment of a foreign economic contract law was necessary to further attract foreign capital and technology and to advance the new economic policy.[15]

Additionally, due to decentralization of China's foreign economic and trade authority since the early 1980's, regional authorities and local enterprises have the power to negotiate directly with

11. Cohen, *Shenzhen's New Contract Law: A Model for China?*, CHINA BUS. REV., Sept.-Oct. 1984, at 16.

12. Horsley, *Contract Mania*, CHINA BUS. REV., Sept.-Oct. 1984, at 13. In the domestic context, Anglo-American common law is well reflected in a case compilation made before and published after the Economic Contract Law. SELECTION OF CASES ON THE RESOLUTION OF DISPUTES OVER ECONOMIC CONTRACTS (1982) (Chinese ed.).

13. *See, e.g., Model Contract for Know-how Licensing by China National Machinery and Equipment Import and Export Corporation*, LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 59-76 (1985) (E. Theroux ed. 1985); *Model Contract for China's Offshore Oil Development-Cooperation with Foreign Companies by China's National Offshore Oil Corporation, id.* at 533-536; Smith, *Standard Form Contracts in the International Trade of the People's Republic of China*, 21 INT'L & COMP. L.Q. 133 (1972); Note, *An Analysis of Chinese Contractual Policy and Practice*, 27 WAYNE L. REV. 1229 (1981).

14. Cohen, *supra* note 11.

15. Speaking on behalf of the Legal Committee of the National People's Congress at the Tenth Session of the Standing Committee, Mr. Shen Hong expressed the committee's view that enacting the FECL had become necessary to ensure the implementation of the open-door policy and to further develop economic cooperation with foreign nations. *See* Shen Hong, *supra* note 3.

foreign companies.[16] As many of these agencies or companies had little or no prior experience in international commerce, a side effect of decentralization has been confusion and disorganization in some areas of foreign trade and economic relations. Cases of unfair arrangements and lack of adequate legal protection have been reported. This is partly due to a lack of legal knowledge or professional experience of some Chinese negotiators, but lack of specific legal guidance also contributed. The uncertainty caused by the inadequacy of China's foreign economic contract law often handicapped Chinese companies in international commercial transactions as much as it hindered their foreign counterparts.[17]

The Foreign Economic Contract Regulation for the Shenzhen Special Economic Zone (Shenzhen FECL), enacted by the Standing Committee of the People's Congress of Guangdong Province in January 1984, was the first comprehensive legislative effort to codify Chinese practice in relation to foreign economic contracts.[18] On October 15 of the same year, the Dalian Economic Zone enacted a similar contract regulation. Based on the experience gained in implementing these regional contract laws, on March 21, 1985, the Sixth National People's Congress passed the current national FECL.[19] Two months later on May 24, 1985, the State Council issued "Regulation of the People's Republic of China Regarding Contracts for Importing Technology".[20] Thus a comprehensive contract law for international transactions began to take shape.

The FECL is a short statute of seven chapters and 47 articles. It represents a significant advance over the Shenzhen FECL and has brought Chinese practice in foreign economic contracts more closely into line with established international practice. However, in most important aspects, the FECL has no more than codified and reaffirmed China's foreign economic practice in light of international commercial customs. The basic principles of the FECL deal-

16. Fung, *China's Decentralization of Foreign Trade,* Asian Wall St. J. Weekly, Nov. 24, 1982, at 6, col. 1.

17. Geng Biao, Vice Chairman of the Standing Committee of the National People's Congress, speaking during the deliberation of the FECL by the Standing Committee, pointed out the consequences of the lack of relevant legal guidance. He said, "we had no laws to rely on in the past and this often resulted in our being out-negotiated in our dealings with foreigners." *Enacting FECL will be Conducive to the Economic Construction of Our Country,* People's Daily, Mar. 17, 1985, at 1.

18. Provisions of the Shenzhen Special Economic Zone on Economic Contracts Involving Foreign Interests, adopted by the Standing Committee of the 6th People's Congress of Guangdong Province on Jan. 11, 1984, and promulgated by the People's Government of Guangdong Province effective Feb. 2, 1984, *reprinted in* CHINA BUS. REV., Sept.-Oct. 1984, at 17 [hereinafter cited as Shenzhen FECL].

19. FECL, *supra* note 1.

20. Regulations of the People's Republic of China Regarding Contracts for Importing Technology, promulgated by the State Council, effective May 24, 1985, *reprinted in* People's Daily, Jun. 4, 1985, at 2.

ing with formation, performance, breach, damages, choice of law, dispute settlement, etc., can all be traced back in some form to the model or other contracts used by the Chinese in the past.[21] As a result, foreign businesses which have dealt with China in the past can expect the FECL to lend more predictability and stability to their dealings with China.

II. THE FECL AND CHINA'S OTHER ECONOMIC CONTRACT LEGISLATION

The FECL is designed to regulate contractual relations between Chinese and foreign enterprises.[22] Since it overlaps with and relates to some of China's other legislation affecting contracts, it is important to understand how the FECL fits into the general contract legal framework as well as China's foreign economic legal framework. The discussion that follows briefly introduces the major elements of the legal structure of Chinese contract law at its present stage of development. It then offers a comparative analysis of the FECL in relation to China's other major legislation relevant to foreign economic contracts.

A. Legal Framework of Contract Law in the PRC — an Overview

Unlike most civil law countries, the PRC has never issued a uniformly codified contract law. Discussions on formulating a civil code that would incorporate a comprehensive contract law were in the air for many years.[23] However, divergent views among Chinese scholars and legislators plus political instability have impeded progress. Though the first attempt to draft the civil code appeared in the mid-1950's, the code was still in the drafting process until early 1986.

Meanwhile, economic policy has dramatically changed since the late 1970's, leading to rapid but imbalanced economic growth. The open-door policy as well as economic reforms have increasingly incorporated elements of free enterprise into a state-planned economy. This unevenness in economic development and diversity in economic composition constitute the social basis for the present pattern of Chinese contract law. The rapid change in the Chinese economy demands a correspondingly prompt legal revolution to

21. Cohen, *Lending to China,* CHINA BUS. REV., Jan.-Feb. 1984, at 40; Torbert, *Contract Law in the People's Republic of China,* in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 214 (M. Moser ed. 1984).

22. FECL, *supra* note 1, art. 2.

23. Kato, *supra* note 10; Jones, *A Translation of the Fourth Draft of the Civil Code (June 1982) of the People's Republic of China,* 10 REV. SOCIALIST L. 193 (1984) [hereinafter cited as Draft Civil Code].

keep pace with increasingly deregulated and complicated economic relations. To quickly remedy this situation, a series of individual contract statutes as well as statutes in other areas have been adopted to meet specialized needs as they occur. Thus while discussions on a comprehensive civil code continue, China's contract law has gradually taken shape out of separate, often overlapping, statutes covering different areas. Uneven economic development among geographic areas and the opening of special economic zones and economy and technology development zones, as well as the rapid expansion in foreign commercial exchanges and investment have created market-oriented economic sectors in some areas within the state-planned national economy. Thus individual contract statutes, enacted to meet the special needs of these sectors and geographic areas, often contain rules that differ from one another. This has led to the creation of different, though interrelated, contract regulatory regimes.

Two regimes can be identified: domestic economic contracts, and foreign economic contracts. Each applies a different set of rules. They can each be divided into three sub-regimes. In the domestic contract area, the domestic ECL represents comprehensive contract legislation,[24] individual contract regulations cover special categories of contracts,[25] and there are also regional or local rules. In the foreign economic contract area, there are the comprehensive FECL, several separate foreign economic regulations dealing with contract issues in special fields, and regional rules such as the Shenzhen FECL.[26]

While the contract rules applicable to the two large regimes

24. ECL, *supra* note 5.

25. There have been numerous regulations governing special types of contracts since the creation of the ECL. These include: Regulations on Contracts of Property Insurance (1983), *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS, BUSINESS REGULATION (CCH Australia) ¶ 9-580; Regulation on Sales Contracts for Agricultural and Related Products (1984); Regulation on Sales Contracts for Industrial and Mineral Products (1984); Regulation on Contracts for Construction and Installation (1983); Regulation on Contracts for Project Feasibility Research and Design (1983); Regulation on Contracts for Processing Products (1984); and Interim Rules for Joint Ventures between Domestic Enterprises. *See Fifteen Economic Statutes Have Been Promulgated in Our Country this Year,* People's Daily, Sept. 13, 1985; *see also* Macneil, *China Needs Only one Legal System,* Asian Wall St. J. Weekly, Dec. 9, 1985, at 14.

26. Other regional foreign economic contract regulations include Interim Rules on the Shenzhen Special Economic Zone Regarding Contracts on Importing Technology, promulgated by the Government of Guangdong province on Feb. 8, 1984; Interim rules of the Shamen Special Economic Zone Regarding Contracts on Importing Technology, promulgated on Feb. 24, 1985 by the Standing Committee of the People's Congress of Fujian Province; Interim Rules of Dalian Economic and Technology Development Zone for Administration of Foreign Economic Contracts Law, promulgated by the City Government of Dalian on Oct. 15, 1984; Interim Rules of Guangzhou Economic and Technology Development Zone Regarding Contracts on Importing Technology, promulgated on April 9, 1985 by the City Government of Guangzhou.

differ considerably,[27] the rules within each general regime are usually similar, especially within the domestic regime. The ECL contains both generally applicable contract principles and specific rules relevant to each area. The special regulations are often derived from rules within the ECL with some elaboration and expansion. As a consequence, there is noticeable harmony and consistency within the domestic regime. Within the foregoing economic contract regime, however, some inconsistency can readily be noticed among the three sub-regimes, particularly between national and regional rules.[28]

The proliferation of individual statutes has also reshaped the draft civil code and changed its role in Chinese contract law. The final version of the civil code, "General Principles of Civil Law" (Civil Code), was promulgated on April 12, 1986.[29] As many independent civil law statutes are already in existence, the Civil Code no longer seeks to provide an all-inclusive set of detailed laws. It is intended instead to set out general principles governing civil law issues not covered by separate statutes, and to stipulate rules commonly applicable in implementing existing civil statutes.[30] The major area left open by existing contract statutes concerns rules governing contractual relations among individuals, as distinguished from those between business entities. The ECL, FECL and Shenzhen FECL all apply only to contractual relations between businesses or between businesses and individuals. Furthermore, some basic principles of contract law uniformily applicable to all contract law statutes, such as rules on offer and acceptance and interpretation, also need to be formulated.

In the area of contract law, the Code has significantly modified its earlier approach. In the fourth draft, circulated in 1982, 241 of the 465 articles directly dealt with contracts.[31] The new Civil Code contains only about 60 articles dealing with contracts and does not contain an independent chapter covering contract law. Provisions on contract law are arranged under various headings. Liabilities for breach of contract, for instance, are discussed within the chapter on

27. See Appendix 1, *infra.*

28. See Appendix 2, *infra.*

29. General Principles of Civil Law of the People's Republic of China, adopted by the Fourth Session of the Sixth National People's Congress on Apr. 12, 1986, *reprinted in* People's Daily, Apr. 18, 1986, at 2-3 [hereinafter cited as Civil Code]. An English translation appears in 34 AM. J. COMP. L. 715-743 (1986).

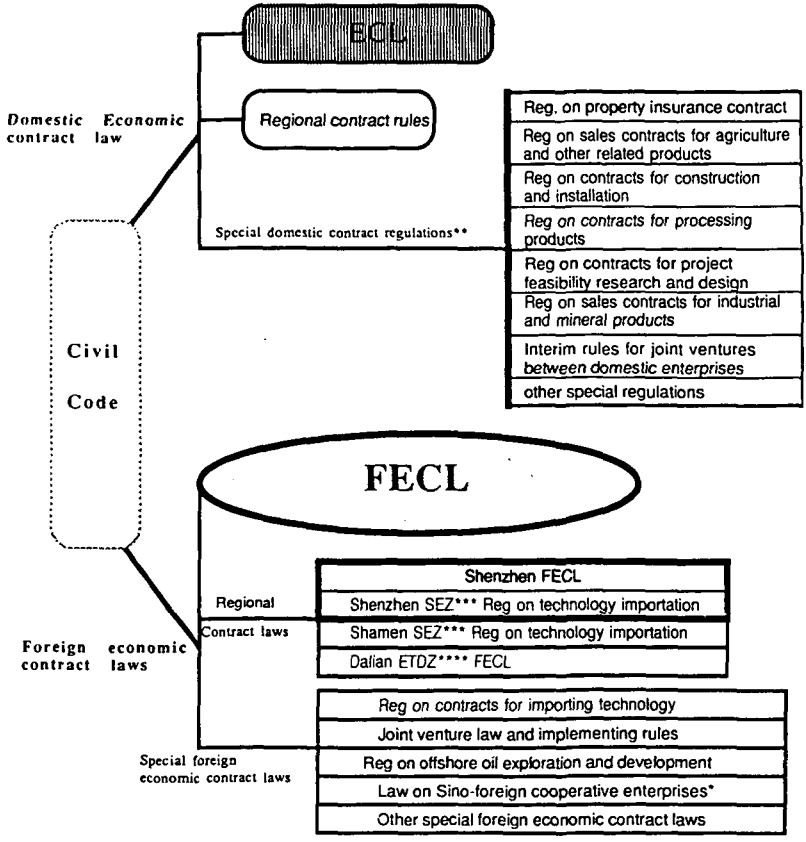
30. Reporting to the 13th Session of the Standing Committee of the National People's Congress, Wang Hanbin, Director of the Legal Affairs Committee of the Standing Committee, stated the purpose of the Code as "providing rules regulating general civil law issues and principles commonly applicable to the implementation of the individual civil law statutes." *See* Our Country Making General Principles of Civil Law, Nov. 31, 1985 (Chinese language news release of the Xinhua News Agency, Peking).

31. Jones, *supra* note 23.

responsibilities, whereas the formation of contracts is discussed in a chapter entitled, "Civil Law Acts."[32]

The following table presents a simplified graphic picture of the legal framework of Chinese contract law.

LEGAL FRAMEWORK OF CHINA'S CONTRACT LAW



Note: *Laws that are still at the drafting stage.
**See note 25 for more information on these regulations.
***SEZ: Special Economic Zone.
****Economy and Technology Development Zone.

B. The FECL and China's Other Major Contract Statutes

This section discusses the relationship of the FECL with several other major contract statutes and the new Civil Code to demonstrate the distinctions and interrelations of the different contract regimes.

1. *The FECL and the Domestic ECL.* The ECL is the most

32. Civil Code, *supra* note 29, ch. 6 § 2; ch. 4 § 1.

important domestic contract law in effect in China. It applies to contractual relations among domestic enterprises, whereas the FECL applies to contracts in which at least one of the participants is non-Chinese.[33] However, the ECL declared that the FECL would be based on the ECL's principles and on international practice.[34] Experience in the application of the ECL may therefore help resolve divergent or unclear interpretations of the FECL.[35]

The ECL contains seven chapters and 57 articles covering contract rules ranging from form requirements to a statute of limitations. In many areas its provisions differ substantially from those of the FECL. Appendix 1 compares the two statutes. It should be noted that the FECL is largely based on freedom of contract, and as one scholar has pointed out, is "like a codification of the Anglo-American common law of contracts."[36] The ECL, on the other hand, is to a great extent a tool to carry out the state plan. For instance, according to the ECL, a contract violating the state plan is void,[37] and a change in the state plan provides a legitimate ground for terminating or modifying a contract.[38] Also, for the purpose of assuring that the state plan is carried out properly and disrupted as little as possible by a breach of contract, specific performance is emphasized. In case of breach, the payment of damages is not a substitute if the non-breaching party requires specific performance.[39] Additionally, the non-breaching party cannot employ self-help through withholding delivery of or payment for goods or services.[40] In order to ensure some punitive effect on the breaching party, the ECL requires that damages should be paid out of the post-tax profit that goes to the enterprise, and not be added to cost.[41] Those provisions are not found in the FECL.

2. *The FECL and the Shenzhen FECL.* The Shenzhen FECL may be regarded as a forerunner or experimental version of the cur-

33. FECL, *supra* note 1, art. 2; ECL, *supra* note 5, art. 2.

34. *See* ECL, *supra* note 5, art. 55 ("Regulations for foreign economic and trade contracts shall be formulated separately with reference to the principles of this law and international practice.")

Although the ECL does not specifically name the FECL, it is clear that the FECL falls within the categories of the regulations that article 55 of the ECL anticipated.

35. This interconnection between the FECL and the ECL should be examined carefully. Although there has been more experience in implementing the ECL, reinforced by a variety of special rules, many of its provisions are much differently worded from those of the FECL. Appendix 1, *infra.*. Thus, interpretation of the ECL by analogy to the FECL is not usually possible.

36. Wilson, *The Legal Structure Governing Technology Transfer and Joint Ventures with the People's Republic of China,* 3 INT'L TAX & BUS. LAW. 1, 18 (1985).

37. ECL, *supra* note 5, art. 7.

38. *Id.* art. 27(2).

39. *Id.* art. 35.

40. *Id.* art. 37.

41. *Id.* art. 36.

rent FECL.[42] They are similar in structure and major provisions, but the FECL benefitted from one year's experience in implementing the Shenzhen FECL, and has made improvements in several important areas. Appendix 2 provides a detailed comparative analysis of the two statutes. In general, the FECL is more liberal than the Shenzhen version, so its provisions are more reassuring to foreign businesses. For instance, the Shenzhen FECL, based on past experience in dealing with underfinanced foreign companies, requires provision of certain performance guarantees.[43] The FECL has no such requirements. The Shenzhen FECL does not clearly provide for parties' choice of law, while the FECL does.[44] In cases where a contract is drafted in more than one language, it makes Chinese prevail while the FECL contains no such rule.[45] Further, compensation for breach of contract in the Shenzhen FECL includes a punitive aspect, for the Shenzhen FECL not only requires the breaching party to pay damages for loss, including a *pro tanto* penalty for late delivery or payment, but also gives the contract supervisory authority discretion to impose an additional fine.[46] The FECL, by contrast, makes provisions for adjustment by the arbitrator or judge of any contractually agreed damages if they are substantially less than or substantially exceed the actual loss.[47]

The FECL is also different from the Shenzhen FECL in its scope of application, which should be of significant interest to the joint ventures and Sino-foreign cooperative production enterprises in China. The Shenzhen FECL not only applies to contracts between Chinese enterprises and foreign business entities and individuals, but also regulates contractual relations between Chinese enterprises and joint ventures or Sino-foreign cooperative enterprises and among joint ventures and Sino-foreign cooperative enterprises.[48] This approach was initially copied by the draft FECL, but was later modified.[49] The present version prevents joint ventures and Sino-foreign cooperative enterprises in China from benefitting from the FECL's liberal provisions in their contractual relations

42. According to Cohen:

Not only has [the Shenzhen FECL] had an immediate impact on many negotiations currently underway in the Shenzhen Special Economic Zone, but the legislation has also been invoked for reference by Chinese negotiators in other zones. Chinese lawyers even refer to it when negotiating investments elsewhere in China, claiming that the long-waited national foreign economic contract law will resemble Shenzhen's. Cohen, *supra* note 11.

43. Shenzhen FECL, *supra* note 18, art. 12.

44. FECL, *supra* note 1, art. 5. *See also* Appendices 1 & 2, *infra.*

45. Shenzhen FECL, *supra* note 18, art. 40. *See also* Appendices 1 & 2, *infra.*

46. Shenzhen FECL, *supra* note 18, art. 32.

47. FECL, *supra* note 1, art. 20.

48. Shenzhen FECL, *supra* note 18, art. 2.

49. Shen Hong, *supra* note 3 (objections were advanced by some Chinese entities represented by the Peking Foreign Economic Relations and Trade Committee).

with other Chinese enterprises and among themselves. A committee report by the Legal Committee of the National People's Congress, reasoning that joint ventures and Sino-foreign cooperative enterprises in China are Chinese juristic persons, stated that these relations will be governed by the domestic ECL.[50] These different provisions in the FECL and the Shenzhen FECL will result in the civil status of joint ventures or Sino-cooperative enterprises located in the Shenzhen Special Economic Zone being different from that of such enterprises located in other areas in terms of their contractual relations.

The Shenzhen FECL does not provide for contractual relations between Chinese individuals and foreign individuals or enterprises. During deliberations, some members of the Standing Committee of the National People's Congress proposed that the national FECL should conform to the growth of private enterprises in the current economic reformation and so should provide a legal framework for Chinese individuals to negotiate economic contracts with foreign businesses.[51] However, due to lack of experience and the complexity of the matter, the Legal Committee eventually rejected the proposal, after consulting with the Ministry of Foreign Economic Relations and Trade.[52] Thus, neither the national FECL nor the Shenzhen FECL applies to contracts negotiated between Chinese individuals and foreign enterprises or individuals.

As China's economic reformation generates more and more private business, foreign businessmen doing business in China should investigate the legal and economic identity of their Chinese counterparts. Failure to do so may lead to the conclusion of a contract with individuals or organizations which are neither the "Chinese enterprises" nor "other economic organizations" mentioned in the FECL,[53] resulting in the non-application of the FECL. However, such danger is currently minimal. Import and export is subject to licensing, and other more complicated foreign economic transactions must be approved by higher authorities. Additionally, both inflow and outflow of foreign currency involved in a transaction is monitored by the Bank of China. This governmental involvment in foreign economic transactions makes this situation very likely to occur.

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50. *Id.*

51. *Enacting FECL will be Conducive to the Economic Construction of Our Country,* People's Daily, Mar. 17, 1985, at 1 (Chinese ed.).

52. Shen Hong, *supra* note 3 (another reason for excluding contracts between Chinese individuals and foreigners from coverage of the FECL is divergence of views within the legislature).

53. FECL, *supra* note 1, art. 2. Article 2 generally provides that contracts covered by the FECL are those negotiated by "Chinese enterprises or other economic organizations." There is no further definition as to what constitutes "Chinese enterprises or other economic organizations."

Resolution of conflicts between the Shenzhen FECL and the national FECL poses an issue which has not been conclusively settled. The Shenzhen FECL is primarily a regional regulation effective in the Shenzhen Special Economic Zone. As a general rule, a special economic zone is permitted by the central government to enact its own regulations, often at variance with the national view.[54] The Chinese Constitution contains provisions implicitly allowing special administrative regions to promulgate their own rules.[55] Thus, the newly enacted national FECL does not automatically preempt the Shenzhen FECL. Furthermore, the Shenzhen FECL contains several provisions of merely local effect, especially those regarding approval and administration of foreign economic contracts by regional authorities.[56] It is thus very likely that the Shenzhen FECL will continue to be effective, together with the national FECL.

Where regional rules or regulations different from national law are allowed to take effect, however, the regulations involved are usually those which provide more liberal treatment than the national law. Rarely could regional rules less favorable to the regulated be effective simultaneously with liberal national rules. This is especially true in the Shenzhen Special Economic Zone, where a basic policy is to provide a more conducive and liberal business environment to foreign investors.[57] Thus, while recognizing that the Shenzhen FECL may remain generally effective, some of its provisions which are not conducive to commercial exchanges with foreign business may be repealed, either in practice or through legislation, in favor of the more liberal approach in the national FECL. There has already been at least one instance where some requirements of the Shenzhen FECL were disregarded by a Chinese enterprise located in Shenzhen in negotiating a technology transfer and sale of equipment contract with an American company.[58]

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54. Several regulations currently in effect in the Shenzhen Special Economic Zone contain provisions which deviate from national laws. In many aspects, the regulations are much more liberal towards foreign investors. *See* Regulation on Entry to and Departure from the Special Economic Zone of Guangdong, adopted at the 13th Session of the 5th People's Congress of Guangdong [hereinafter cited as Guangdong Regulations].

55. CONST. PEOPLE'S REPUBLIC OF CHINA (adopted at the 5th Session of the 5th National People's Congress on Dec. 4, 1982). Article 31 of the Constitution permits the state to establish special administrative regions which will, as pointed out in the Report on the Draft of the Revised Constitution by Peng Zhen, Vice Chairman of the Constitution Revision Committee, enjoy high autonomy. *See* Peng Zhen, Report on the Draft of the Revised Constitution, Speech at the 5th Session of the 5th National People's Congress (Nov. 26, 1982). Article 116 of the Constitution also permits minority nationality autonomy regions to make their own law. This provides an analogy to aid understanding of Shenzhen's status.

56. Shenzhen FECL, *supra* note 18, arts. 2, 31, 33, 39.

57. *See* Guangdong Regulations, *supra* note 54.

58. The author was invited to comment on a technology transfer and equipment

C. The FECL and Other Special Foreign Economic Contract Regulations

In addition to the FECL, which is the comprehensive foreign economic contract legislation, the Chinese government has also promulgated several special foreign economic law and regulations governing contracts in special areas. These include, in particular, the Law of the People's Republic of China on Chinese-Foreign Joint Ventures and corresponding implementing regulations;[59] Regulations of the People's Republic of China on the Exploitation and Development of Offshore Petroleum Resources in Cooperation with Foreign Enterprises;[60] and the Regulation of the People's Republic of China Regarding Contracts for Importing Technology.[61] The law governing Sino-foreign cooperative enterprises now under deliberation in the Chinese legislature also belongs to this category.[62] These special regulations are concerned with the substance of the relevant foreign economic activities, while the FECL deals only with their forms. Thus, conflicts between the FECL and those statutes are not likely to occur. Additionally, the FECL expressly empowers the State Council to stipulate implementing rules which will provide a detailed interpretation of the FECL.[63] However, these rules once promulgated are unlikely to focus on contracts in special areas and therefore will not become part of the special foreign economic contract regime.[64]

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sales contract between an American client and a Chinese company in the Shenzhen Special Economic Zone. The transaction was fairly complicated, as it involved technical assistance, personnel training and other arrangements which were to last as long as 10 years. The contract was clearly governed by the Shenzhen FECL, including its mandatory provision that both parties to a contract provide guarantees of performance. However, a contract clause inserted by the American company that obligated the Chinese party to provide a guarantee for performance through a Hong Kong company, together with a letter of credit without the American side incurring a like obligation, was apparently accepted by the Chinese negotiator without much difficulty.

59. The Law of the People's Republic of China on Chinese-Foreign Joint Ventures, adopted at the 2d Session of the 5th National People's Congress on July 1, 1979, *reprinted in* CHINA'S FOREIGN ECONOMIC LEGISLATION 1-12 (1982).

60. Regulations of the People's Republic of China on the Exploitation and Development of Offshore Petroleum Resources in Cooperation with Foreign Enterprises, adopted by the State Council on Jan. 12, 1982, *reprinted in* LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 537-543 (E. Theroux ed. 1985).

61. Regulations of the People's Republic of China Regarding Contracts for Importing Technology, promulgated by the State Council effective May 24, 1985, *reprinted in* People's Daily, Jun. 4, 1985, at 2.

62. *See Fifteen Economic Statutes Have Been Promulgated in Our Country this Year,* People's Daily, Sept. 13, 1985; *See also* Macneil, *China Needs Only one Legal System,* Asian Wall St. J. Weekly, Dec. 9, 1985, at 14.

63. FECL, *supra* note 1, art. 42.

64. Implementing rules promulgated by the Chinese government include: Regulations for Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (1983), *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS, BUSINESS REGULATION (CCH Australia) ¶ 6-550; Regulations for

D. The FECL and the Civil Code

The Civil Code contains a chapter dealing with foreign-related transactions and also provides general principles on the law of contract.[65] After it goes into effect on January 1, 1987,[66] the Code will clarify many issues left open by the FECL and will also provide guidelines for its application. The impact of the Code on the FECL can be summarized as follows.

First, filling a loophole left by the FECL, the Code contains detailed provisions concerning capacity to contract which will apply to foreign individuals as well as Chinese nationals. Under the Code, citizens below the age of 18 are minors and the effect of their contractual acts varies.[67] Citizens and foreign nationals below the age of 10 are completely without capacity to contract, so that contracts they make are void.[68] Those over 16 but under 18 are deemed completely competent to contract if they rely for most of their support on income from their own labor.[69] Minors above the age of 10 have limited capacity to contract and only transactions commensurate with their intelligence or age are effective.[70] The Code further provides that contractual acts of a person mentally incapable of understanding his own acts are void.[71]

Second, the Code contains provisions with respect to mistake, unconscionability and illegality not treated by the FECL. Under the Code, a contractual act such as an offer or acceptance is voidable by a party who significantly misunderstands the meaning of the

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Implementation of the Law of Income Tax for Sino-Foreign Joint Ventures of the People's Republic of China, (1980) *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS, TAXATION (CCH Australia) ¶ 33-510; Regulations for Implementation of the Law of Income Tax for Foreign Enterprises of the People's Republic of China, (1982), *reprinted in id.* ¶ 32-510; Regulations for Implementation of the Law of Personal Income Tax of the People's Republic of China, (1980), *reprinted in id.* ¶ 30-520; Regulations for Implementation of the Patent Law of the People's Republic of China, (1985), *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS, BUSINESS REGULATION (CCH Australia) ¶ 11-603; and Regulations for Implementation of the Trade Mark Law of the People's Republic of China, (1980), *reprinted in id.* ¶ 11-520. There are also implementing regulations on import and export licensing and inspection. *See, e.g.*, Implementation Rules on the Inspection of Import and Export Commodities of the People's Republic of China (1984), *reprinted in* CHINA LAWS FOR FOREIGN BUSINESS, CUSTOMS (CCH Australia) ¶ 52-530. These implementing rules have demonstrated a general pattern in Chinese administrative and legislative practice in the making of implementing rules. The rules generally address provisions contained in the relevant major statutes and serve as interpretative tools rather than extending the coverage of the major statute to new areas or creating new special rules. It is likely that the implementing rules for the FECL will follow the same general pattern.

65. Civil Code, *supra* note 29, ch. 8.
66. *Id.* art. 156.
67. *Id.* arts. 11, 12 & 13.
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.* art. 13.

act or as to whom the act is obviously unfair.[72] The Code also provides that a contract violating a mandatory state plan or to achieve an illegal purpose is void.[73] These matters are either not covered at all or not expressly provided for in the FECL.

Third, the Code contains more detailed rules than the FECL on the time limits for initiating dispute settlement procedures. The FECL provides only for a four-year limit for disputes arising from international sales contracts.[74] The Code provides for a one-year limit for disputes arising from a lease or bailment.[75] It also contains detailed rules regarding calculation of time limits and on the discretion of the court.[76]

Fourth, the Code furnishes provisions supplementary to the choice of law clause in the FECL. The Code reaffirms the rules of the FECL such as the superiority of international treaties and application of international customs and foreign laws.[77] The Code, however, further provides that foreign law or international customs may not be applied so as to violate the social and public interest of the PRC.[78] This provision is not found in the FECL.

Fifth, the Code contains much more detailed rules on secured transactions. The FECL only discusses posting a security deposit as a means to guarantee performance.[79] Article 18 of the draft FECL contained a provision on the right of liens of the obligee if the contract or performance of the contract involved possession by the obligee of the obligor's property.[80] This provision was deleted in the final version of the FECL and is now reinstated by the Civil Code.[81] The Code also reaffirms the security deposit provision of the FECL.[82] Further, it authorizes third party guarantees or the posting of property to guarantee the performance of a contract.[83]

Finally, the Code contains a set of rules concerning contractual interpretation where the contract fails to provide for such important elements as price, place and time of performance, and quality of products.[84] The FECL does not cover these topics.

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72. *Id.* art. 59.
73. *Id.* art. 58
74. FECL, *supra* note 1, art. 39.
75. Civil Code, *supra* note 29, art. 136.
76. *Id.* art. 138, 139 & 140.
77. *Id.* art. 142.
78. *Id.* art. 150.
79. FECL, *supra* note 1, art. 18.
80. Shen Hong, Explanations on some Modifications of the Draft FECL, Reports of the Standing Committee of the National People's Congress, Bulletin of the Standing Committee of the National People's Congress, No. 2, at 15 (1985).
81. Civil Code, *supra* note 29, art. 89.
82. *Id.*
83. *Id.*
84. *Id.* art. 88.

III. THE FECL AND COMMON LAW CONTRACT PRINCIPLES

A. Formation of Contract

According to Article 7 of the FECL, a contract is concluded when parties have reached and signed a written agreement as to the specific provisions of the contract.[85] Thus, an effective foreign economic contract under the FECL must be in writing, whether it relates to real estate, investment, or sales of goods. This is in contrast with the common law principle that only certain contracts, such as those concerning real estate, those for sale of goods with the value above a certain amount or those under which the duration of performance shall be over one year need to be in writing.[86] Note that Chinese law permits oral contracts to be used for certain domestic economic transactions.[87]

As to issues relating to offer and acceptance, the FECL contains no provision. However, Articles 129 to 131 of the Draft Civil Code reflected principles which are similar in several respects to the common law rules concerning the effect of offer and acceptance. For instance, the Draft Civil Code required that acceptance had to be a "mirror image" of the offer.[88] Any deviation would create a counter-offer.[89] However, the Draft Civil Code also contained rules on offer and acceptance which differed from common law principles. For example, it required that acceptance be immediate if the offer was made without a time limit, whereas the common law only requires that acceptance be made within a reasonable time.[90] The common law "mail box" rule was reflected only in a qualified manner. According to the Draft Civil Code, if acceptance was dispatched on time but delayed in transmission, the offeror who received it late would be bound unless he immediately informed the

85. FECL, *supra* note 1, art. 7.

86. All American jurisdictions except Louisiana have adopted in some form a statute of frauds, which requires that certain types of contracts must be in writing to be enforceable. They are usually contracts concerned with executor-administrator relationships, suretyship, promises of marriage, sales of land, or contracts with a duration of performance of over one year. Other oral contracts are enforceable. The U.C.C. requires writing for contracts on sales of goods for $500 or more, and on sales of other personal property exceeding $5,000 and of securities. U.C.C. §§ 2-201, 1-206, 8-319.

87. FECL, *supra* note 1, art. 3 permits oral contracts for transactions that can be completed instantly.

88. "An acceptance that changes the terms of the offer must be regarded as a new offer made by the other party." Draft Civil Code, *supra* note 23, art. 131.

89. *Id.* For common law rule, see Poel v. Brunswick-Balke-Collender Co., 216 N.Y. 310 (1915).

90. Draft Civil Code, *supra* note 23, art. 131. For common law "mailbox" rule, see Adams v. Lindsell, 106 Eng. Rep. 250 (1818).

offeree.[91]

The final version of the Chinese Civil Code as promulgated does not contain these rules. However, these rules very much reflect the general practice and the prevailing understanding among Chinese jurists and therefore should be noted as an important secondary reference for the Chinese contract law. Additionally, some regional foreign economic contract regulations also contain relatively detailed rules governing offer and acceptance. For instance, under the Regulations of the Dalian Economic and Technological Development Zone for Administration of Foreign Economic Contacts, an offer becomes effective at the time when it reaches the offeree and a notice of withdrawal or alteration of the offer is valid only if it reaches the offeree prior to the dispatch of acceptance by the offeree.[92] The regulations also provide that a contract is deemed to be established when the acceptance reaches the offeror, and acceptance not in conformity with the offer is regarded as a new offer.[93] The regulations further provide that a withdrawal of acceptance by the offeree is valid only if it reaches the offeror before or at the same time as the acceptance is received.[94] These rules are effective only within a small area of Dalian, but serve as an important reference in understanding Chinese contract rules concerning offer and acceptance.

It should be noted that unilateral contracts, where acceptance occurs by full performance, are not anticipated by the FECL, as every contract must be signed by both parties.[95]

B. Invalid Contract

The FECL outlines three types of situations where a contract will be considered invalid: 1) contracts violating the laws of the PRC; 2) contracts contrary to public and social interests; and 3) contracts induced by duress or fraud.[96] The rules in the first and third categories readily find their parallel in common law.[97] The second category is very similar to the common law rule on public policy and unconscionability.[98] Also like the common law, the FECL recognizes the severability of contracts, and provides that the invalidity of some provisions of a contract will not affect the validity

91. *Id.*

92. Regulations of the Dalian Economic and Technological Development Zone for Administration of Foreign Economic Contracts, *supra* note 26, arts. 11-12.

93. *Id.* art. 14.

94. *Id.* art. 15.

95. FECL, *supra* note 1, art. 7.

96. *Id.* arts. 9-10.

97. 17 AM. JUR. 2D *Contracts* §§ 501-504 (1964).

98. *See* U.C.C. § 2-302; RESTATEMENT (SECOND) OF CONTRACTS § 208 (1979).

of other parts of the same contract.[99] The FECL does not have any provision similar to the common law concept of "voidability." However, the new Civil Code incorporates this concept. Under the Civil Code, a contract which is obviously unfair or made with significant misunderstanding of a party about his contracted act is voidable.[100] The aggrieved party may petition the court or arbitrator to declare the contract void.[101] A rule implicit in the FECL is that in order for a law to invalidate certain categories of contracts the law must be in effect at the time of conclusion of the contract.[102] The FECL accords special protection to contracts concerning foreign joint venture and cooperative investment in China for the development of natural resources in cooperation with foreign business. Contracts in these categories will not be affected or impaired by subsequent legislation.[103]

C. Performance of Contract

The FECL stresses the binding effect of a valid contract. However, like section 2-609 of the Uniform Commercial Code (U.C.C.), it also permits parties to suspend performance when there is a strong likelihood that the other party will not live up to its obligations, so long as the suspending party has adequate evidence and informs the other party promptly.[104] When the other party provides adequate assurance, the party must resume its performance.[105] Suspension of performance without adequate evidence demonstrating likelihood of default by the other party amounts to a breach.[106] Unlike section 2-609 of the U.C.C., the FECL however does not specify what constitutes adequate assurance or adequate evidence.[107] As a result, the FECL provisions, unless supplemented by other specific rules of implementation, may lead to uncertainty.

The FECL specifically requires that a contract detail basic elements of performance such as price, place, time, etc.[108] The FECL does not provide rules applicable where the time and place of performance or the price are not clearly stipulated and cannot be deter-

99. FECL, *supra* note 1, art. 9. For the common law rule, see RESTATEMENT (SECOND) OF CONTRACTS § 183 (1979).

100. Civil Code, *supra* note 29, art. 59

101. *Id.*

102. FECL, *supra* note 1, art. 40; *see also* Cordes v. Miller, 39 Mich. 581 (1878); Miller & Co. v. Taylor & Co. 1 K.B. 402 (1916).

103. FECL, *supra* note 1, art. 40.

104. *Id.* art. 17. U.C.C. § 2-609(2).

105. *Id.*

106. *Id.*

107. "Between merchants the reasonableness of grounds for insecurity and adequacy of any assurance offered shall be determined according to commercial standards." U.C.C. § 2-609(2).

108. FECL, *supra* note 1, art. 12.

mined in light of other provisions in the contract or through consultations between the parties.[109] Under the Civil Code, where quality is not clearly specified in the contract, the national standard, or the ordinary standard in the event that there is no national standard, is applicable.[110] The Civil Code does not contain a further definition of "ordinary". However, it seems to incorporate a standard similar to that employed by the U.C.C. implied warranty sections, requiring that the goods or service covered by a contract be merchantable or fit for the purposes for which the seller has reason to know the buyer is purchasing them. Where the time of performance is not specified, the obligor may perform and the obligee may request performance at any time.[111] When such a request is made, the obligee shall allow the other party necessary time for preparation. Where the place of performance is not clearly provided, the location of the obligor shall be the place of performance[112] unless the subject of performance is the payment of cash, in which case the location of the obligee shall be the place of performance.[113] Where price is not clearly stated in the contract, the State price, that is, the price fixed by the State, shall apply.[114] If there is no State price, reference shall be made to the market price of the product or service, or of similar products or services.[115]

D. Breach and Damages

Breach is defined in the FECL as non-performance or performance not in conformity with the terms of a contract.[116] The non-breaching party is obligated to take appropriate steps to "cover" or otherwise prevent aggravation of its loss. There can be no recovery of damages for losses that result from the aggrieved party's failure in this regard.[117] This is similar to the common law[118] and U.C.C.[119] principle of mitigation, which states that the non-breaching party may not recover damages that could have been avoided by reasonable effort.

The principle governing recovery under the FECL is similar to

109. Civil Code, *supra* note 29, art. 88.
110. *Id.*
111. *Id.*
112. *Id.*
113. *Id.*
114. *Id.*
115. *Id.*
116. FECL, *supra* note 1, art. 18.
117. *Id.* art. 22.
118. *See* Cedar Rapids & I.C.R.L. v. Sprague Elec. Co., 280 Ill. 386, 117 N.E. 461 (1917).
119. U.C.C. § 2-715 (2)(a) specifies the recoverable consequential damages from the seller's breach as including "any loss . . . which could not reasonably be prevented by cover or otherwise."

the common law concept of compensatory damages. According to the FECL, the obligation of the breaching party for damages shall be limited to the actual loss accruing to the other party as a consequence of the breach.[120] These damages shall not exceed the amount that the breaching party could have foreseen at the time the contract was formed.[121] Punitive and consequential damages are apparently not recoverable under the FECL.[122]

The FECL permits the parties to determine in the contract what damages will be recoverable.[123] It further provides that where the pre-determined damages far exceed or are much less than the loss, the aggrieved party may petition in arbitration or in court for adjustment of the damages.[124] This is similar to the common law principle under which courts scrutinize liquidated damages provisions to determine whether they are reasonable and without punitive effect. Under the common law, pre-set damages are enforceable only if they represent a good faith effort by the parties to estimate the actual damages likely to ensue from a breach.[125] However, unlike the FECL, common law does not give a court the power to adjust the damages provided in a contract.

E. Assignment and Delegation

The FECL covers assignment of contract rights and obligations in the same provision, providing that all parties to a contract must agree to an assignment.[126] It is further provided that where the law requires a contract to be approved by Chinese authorities, an effective assignment or delegation is conditional on approval by the same authority.[127] Under common law, all contract rights are assignable unless the assignment would materially change the duty of the obligor or materially increase its burden or risks of performance.[128] Common law further provides that duties of a contract are generally delegable unless the obligee has a substantial interest in having the original obligor perform them personally.[129] These rules are not found in the FECL.

The FECL permits parties to contract for special provisions

120. FECL. *supra* note 1, art. 19.

121. *Id.*

122. Even the damages that the parties specified in the contract can be reduced through arbitration or judicial proceedings if they exceed substantially the actual loss. Thus damages with punitive effect are virtually not allowed. FECL, *supra* note 1, art. 20.

123. FECL, *supra* note 1, art. 20.

124. *Id.*

125. *See* Gustafson & Co. v. State, 156 N.W.2d 185 (S.D. 1968).

126. FECL, *supra* note 1, arts. 26 & 27.

127. *Id.*

128. 6 AM. JUR. 2D *Assignment* § 9 (1963).

129. RESTATEMENT (SECOND) OF CONTRACTS § 151(b) (1979).

regarding assignability. Thus, the agreement of the other party to an assignment or delegation may be pre-obtained. As for the approval requirement, the FECL provides that if a contract already approved by the Chinese authorities contains a provision making unnecessary further approval for assignment, the requirement of approval will be considered waived.[130]

F. Choice of Law

The FECL has adopted a liberal approach with respect to choice of law in contracts. The FECL generally permits the parties to choose the law for the settlement of dispute.[131] Where the parties fail to do so, the FECL requires that the law that has the closest, most immediate relationship to the contract will apply.[132] However, the FECL mandates that Chinese law be used for joint venture contracts, contracts establishing cooperative enterprises with foreign business, and contracts concerning development of natural resources in cooperation with foreign business.[133] If Chinese law does not have specific provisions concerning a particular dispute the FECL allows international practice to be applied.[134] However, foreign laws and international customs may not be applied so as to violate the public or social interests of the PRC.

The conflict of law rules in the FECL are substantially similar to principles generally recognized in common law.[135] For example, the Second Restatement of Conflict of Laws recognizes that parties have the power, subject to certain limitations, to choose the applicable law, and designates the applicable law in the absence of an effective choice as the local law of the state which has the most significant relationship to the transaction and the parties.[136]

In contracts concerning joint ventures and development of natural resources where the FECL requires Chinese law to be applicable, foreign businesses should not be discouraged by the apparent limitation on the freedom of contract. In common law, the choice of law is also limited by the principle that for the court to be bound by the law that the parties to the contract choose, there must be a logical basis for applying such law; the law chosen must be that of a jurisdiction having some relation to the agreement — generally either the place of making the contract or the place of perform-

130. FECL, *supra* note 1, art. 27.
131. *Id.* art. 5.
132. *Id.*
133. *Id.*
134. *Id.*
135. 16 AM. JUR. 2D *Conflict of Laws* §§ 74-96 (1979).
136. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 186-188 (1979).

ance.[137] The FECL specifically requires application of Chinese law to contracts concerning investment in China. Those contracts are usually negotiated in China and are to be performed in China. In the case of contracts on development of natural resources, the subject matter of the contract is also in China. Chinese law likely would be viewed as the law having the most substantial relationship to the contract, and would therefore be the applicable law even under common law rules.

The inconvenience to foreign businesses from application of Chinese law is mitigated to a great extent by other provisions in the FECL. First, the FECL provides that if Chinese law contains provisions at variance with an international treaty in which China participates, the treaties should apply.[138] Thus many foreign businesses whose countries have concluded investment protection treaties with China will have some protection from the effect of any Chinese law which might otherwise affect the investment interest.[139] Second, the FECL provides that international practice will apply in the absence of specific provision in Chinese law.[140] Finally, as further assurance, Article 40 of the FECL provides that future changes in Chinese law will not apply to those classes of contracts to which Chinese law must be applied.[141]

There is some question about the scope of choice of law allowed. The FECL permits choice of law only in relation to dispute settlement, whereas the common law concept of choice of law extends to any aspect of the contract from capacity of the parties to the legality of the contract.[142] However, since disputes may arise at any point in the contract process, arguably, the permissible range of choice of law under the FECL may be as extensive as in common law. This proposition is valid only if the FECL's choice of law provision allows the parties to a contract to apply the designated law to both substantive and procedural aspects of dispute settlement. However, it has been suggested that the FECL's choice of law clause only extends to the procedural aspect of dispute resolution. This would mean that parties to a contract can only apply the desig-

137. National Union Fire Ins. Co. v. D & L Constr. Co., 353 F.2d 169 (8th Cir. 1965); Siegelman v. Cunard White Star, 221 F.2d 189 (2nd Cir. 1955).

138. FECL, *supra* note 1, art. 6 (the FECL also expressly excepts those provisions of a treaty to which China has made reservation).

139. The Chinese government has conducted negotiations on investment protection and investment guaranties agreements with several foreign governments sometimes, as in the case of the United States, leading to formal agreements. *See* Agreement Relating to Investment Guaranties, Oct. 30, 1980, United States-People's Republic of China, 32 U.S.T. 4010, T.I.A.S. No. 9924.

140. FECL, *supra* note 1, art. 5.

141. *Id.* art. 4.

142. "Parties may choose the law for the settlement of disputes arising from the contract." *Id.* art. 5.

nated law to determine the manner in which a given dispute is resolved and the procedure through which such a resolution is carried out, while leaving the more crucial substantive part of the dispute settlement to be determined by Chinese law. At present, neither argument has any practical support.

G. Dispute Settlement

The FECL outlines dispute settlement procedures including consultation, mediation, arbitration and judicial proceedings, with an emphasis on consultation and mediation.[143] Chinese practice favors bilateral resolution of disputes, which in the Chinese view is conducive to maintaining a friendly relationship and mutual confidence between the parties. The FECL does not, however, impose any specific procedure on the parties. Although the FECL encourages the parties to endeavor to settle the matter through consultation or mediation, it permits parties unwilling to settle to resort directly to arbitration.[144] Arbitration can be held either in China or abroad, depending on the provisions of the arbitration clause in the contract or a subsequent special agreement between the parties.[145] However, just as foreign negotiators tend to be reluctant to accept Chinese arbitral institutions, Chinese parties to contracts usually refuse to accept arbitration in the country of the other party. In practice, this is usually resolved by an agreement to submit disputes to arbitration in a neutral jurisdiction by a neutral institution.[146]

The FECL generally does not favor judicial proceedings. Litigation is allowed either where there is no arbitration clause in the contract, or where parties are unable to reach an agreement on arbitration after a dispute has begun.[147] This is consistent with Article 192 of the Civil Procedure Law of the People's Republic of China

143. *Id.* arts. 37-38.

144. *Id.*

145. *See* Agreement on Trade Relations, July 7, 1979, United States - People's Republic of China, art. VIII(2), 31 U.S.T. 4651, T.I.A.S. 9630. This agreement provides that:

> If such dispute cannot be settled promptly by any one of the above-mentioned means, the parties to the dispute may have recourse to arbitration for settlement in accordance with provisions specified in their contracts or other agreements to submit to arbitration. Such may be conducted by an arbitration institution in the United States of America or the People's Republic of China, or a third country

See also Potter, *Resolving Contract Disputes,* China Bus. Rev., Sept.-Oct. 1984, at 21; Surrey, *Dispute Settlement in US-China Trade—Another Look,* in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 277 (E. Theroux ed. 1985).

146. The Stockholm Institute, the London Court of Arbitration, and the Zurich Chamber of Commerce are the neutral arbitration tribunals often accepted by Chinese negotiators. The Chinese will not resort to the International Chamber of Commerce because of Taiwan's representation in that organization.

147. FECL, *supra* note 1, art. 38.

which denies access to the courts to parties which have concluded a written arbitration agreement.[148] In the event that a court proceeding is needed, the FECL makes it clear that an appropriate forum is the "People's Court" — the Chinese court.[149] However, the Chinese court is apparently not the exclusive forum for judicial settlement. Article 38 of the FECL, dealing with judicial settlement of contract disputes, appears to say that using Chinese courts is only one of several options available to the parties.[150] This interpretation is confirmed by current Chinese contract practice. It has been reported that the jurisdiction of New York, Japanese and Hong Kong courts has been accepted in loan agreements between Chinese and foreign banks.[151] In general, however, it is still exceptional for Chinese parties to a contract to accept foreign jurisdiction.[152]

Another issue relevant to judicial proceedings for dispute settlement is judicial enforcement and judicial review of arbitral awards. The FECL does not contain any provision in respect to these matters. Chinese courts may enforce arbitral awards by Chinese institutions but may not review awards or set them aside.[153] It is not clear what the attitude of the courts will be where a foreign arbitral award is involved. However, under the US-China Trade Agreement, China is obliged to "seek to ensure that arbitration awards are recognized and enforced . . . in accordance with applicable laws and regulations."[154] Both the Civil Procedure Law and the FECL clearly specify that international agreements in which China participates will prevail over domestic law.[155] As a result, foreign arbitral awards concerning US businesses should be recognized and enforced by Chinese courts.[156] In practice, China has demonstrated a willingness to recognize and accept foreign arbitral awards. Chi-

148. Civil Procedure Law of the People's Republic of China, adopted by the Standing Committee of the Fifth National People's Congress at its 22nd session on Mar. 8, 1982, art. 192 [hereinafter cited as Civil Procedure Law].

149. FECL, *supra* note 1, art. 38.

150. "In case there is neither an arbitration clause provided in the contract nor a written arbitration agreement reached afterwards, parties *may* bring suit in the People's Court." *Id.* (emphasis added).

151. *Lending to China,* China Bus. Rev., Jan.-Feb. 1984, at 40. (in an agreement with the U.S. EximBank, the Bank of China agreed to submit to the jurisdiction of *any* United States federal court sitting in New York or the District of Columbia).

152. The author has witnessed the difficulties in persuading Chinese negotiators to agree to incorporating into a technology transfer contract a provision that would submit contract disputes to U.S. jurisdiction.

153. Civil Procedure Law, *supra* note 148, arts. 192-193.

154. Agreement on Trade Relations, *supra* note 145, art. VIII.

155. FECL, *supra* note 1, art. 6; Civil Procedure Law, *supra* note 148, art. 189.

156. Article 8, paragraph 3 of the Agreement on Trade Relations does not clearly indicate whether "awards" includes both foreign awards and domestic awards or whether it means domestic awards only. However, if this paragraph is read together with the other two paragraphs of the same article, it appears clear that the foreign awards are included. Agreement on Trade Relations, *supra* note 145, art. VIII ¶ 3.

nese officials have stated on many occasions that China will abide by arbitral awards and that Chinese courts will enforce foreign awards.[157] Currently, China is considering joining the United Nations Convention for the Recognition and Enforcement of Foreign Arbitral Awards.[158]

H. Excuse of Performance

Under the FECL, performance of a contract can be excused principally in the following three situations: 1) frustration of the expectation of economic benefit as a result of the other party's breach; 2) impossibility of performance due to force majeure; and 3) occurrence of conditions excusing performance provided for in the contract.[159] The FECL defines force majeure as an event that the parties could not foresee at the time of conclusion of the contract and whose occurrence and consequences cannot be avoided or overcome.[160] Article 24 apparently encompasses most of the events that common law principles of impossibility consider to excuse performance.[161] However, the broader common law rule concerning frustration is probably not within the purview of the FECL. The FECL permits parties to a contract to specify events of force majeure or other conditions excusing performance.[162]

In common law, supervening changes in the law may discharge a party's contractual obligation if the new law makes performance illegal.[163] Fear of changes in Chinese law that might impair foreign interests frightens away quite a few foreign businesses. In order to establish trust and credibility, Chinese leaders have given repeated assurances that current policies will be maintained and foreign economic interests protected.[164] The FECL has further strengthened those assurances, providing that approved contracts for Chinese-foreign equity joint ventures, Chinese-foreign cooperative enterprises, and Chinese-foreign cooperative exploitation and development of natural resources to be performed within the PRC, will not be adversely affected by any new laws.[165] The three types of con-

157. Surrey, *supra* note 145.
158. *Id.* at 286.
159. FECL, *supra* note 1, art. 29.
160. *Id.* art. 24.
161. *Id.*
162. 17 AM. JUR. 2D *Contracts* §§ 10, 404-424.
163. RESTATEMENT (SECOND) OF CONTRACTS § 264 (1979).
164. Chinese Premier Zhao Ziyang gave assurances to foreign businessmen at a reception he hosted for a group of American and Italian entrepreneurs. He stressed that China will not alter the terms of contracts for this or that reason. Speaking about the concerns of foreign investors with the immature or imperfect Chinese economic and legislative systems, he pointed out that their concerns are unnecessary, for the contracts in China have the status of law. *See* People's Daily, Dec. 4, 1983.
165. FECL, *supra* note 1, art. 40.

tracts specially designated usually involve relatively long-term and substantial foreign investment. Foreign businesses involved in such contracts generally have a substantial economic interest in maintaining the continuity of the contract, so the special protection and assurance provided by the FECL is necessary to attract foreign investment. In practice, protection against adverse effects of subsequent legislation is not limited to these three types of contracts. There are instances where contracts concerning technology transfer, finance and leases have been exempted from the application of new legislation that would otherwise have accorded foreign parties less favorable treatment.[166]

IV. CONCLUSION

It is important to bear in mind that the FECL is a short statute providing only the most general rules. It inevitably leaves many questions to be answered in subsequent practice. It is therefore difficult to compare in detail with the legal framework in common law systems, which enjoy a profound literature enriched by the experience of several centuries. However, when compared with the Shenzhen FECL, the national FECL already shows a pattern of development in Chinese contract law. It has adopted a relatively liberal approach in allowing the parties a great deal of latitude to negotiate a variety of contract terms. Furthermore, many common law rules and the contract laws of European countries do find parallels in the FECL. In those areas in which the FECL differs from common law rules, the FECL usually permits parties to negotiate special contractual arrangements. Thus, foreign businesses should be careful to negotiate clear and detailed contractual provisions, rather than being concerned about possible interpretations of the FECL rules or frustrated by contingencies for which provision has not been made.

166. An example is the Ministry of Finance ruling of Nov. 5, 1980, concerning the application of tax laws to joint ventures established prior to the enasctment of such tax laws. This ruling allowed joint ventures and foreign parties to joint ventures to continue to enjoy the tax benefits provided for under the joint venture contract. The Ministry of Finance ruling further provided that in the event that the tax laws imposed a lesser tax than that provided for under the joint venture contract, the tax laws should apply.

Appendix 1: FECL and ECL(1)

	ECL	FECL
Scope of Application	Any economic contracts between legal persons, which, refers to business or state entities. Arts. 2 and 55.	Any contracts between foreign and domestic enterprises except for those concerning international transportation. Art.2.
Form of Contracts	Writing is required, except for contracts that can be completed instantly. Art. 3.	Writing is required. Letters, telegrams or telexes can be considered as agreement. Confirmation of approval is optional. Art. 7.
Invalid Contract	1) Contracts violating PRC law; 2) Contracts violating national policy; 3) Contracts contrary to national or public or social interest; 4) Contracts violating the state plan; 5) Contracts induced by duress or fraud. 6) Contracts concluded by an agent exceeding his power of attorney or with himself in the name of the principle or with another person he represents. Art. 7.	1) Contracts violating PRC law; 2) Contracts countrary to public or social interest; 3) Contracts induced by duress or fraud. Art. 9 and 10.
Penalty for invalid contract	Party who is at fault shall be responsible for the loss of the other party. If both are at fault, each shall bear its own responsibility. If an invalid contract for violating national, social or public interests results from intentional misconduct of the party or parties, the state will confiscate the subject-matter property of the party or parties at fault. Art. 16.	None.
Warranty	Quality of goods in contract on sales of goods should be provided in the contract in accordance with the standard set by the state or profession, or special requirement of the party. Art. 17.	No express provision.
Price of Contracts	Price on sales of goods shall be provided in contract in conformity with the price set by the state or other authorities. Parties are free to negotiate on price only for those items that the policy permits. Art. 17.	No express provision.
Requirements respecting negotiation of contracts	Agent contracting on behalf of of the principal must obtain a power of attorney in advance and act in the name of principal and within the limit of authority. Art. 10. Contracts dealing with items covered by the state mandatory plan should be made in accordance with the quotas set by the state. Art.11.	None.

Appendix 1: FECL and ECL(2)

	ECL	FECL
Formation of contracts	A contract is formed if the parties reach an agreement on the principal privisions of a contract, which include: 1) subject matter, 2) quantity and quality 3) price or compensation 4) time, place and manner of performance 5) responsibility for breach 6) other provisions that the law requires or become necessary because of the nature of the transaction, or one party requires to be included. Art.9 and 12.	A contract is formed when the parties reach a written agreement on its provisions and sign it. Art.7.
Payment: currency and method.	Unless specifically provided by law, Chinese currency "Renminbi" shall be the tender. Payment shall be made through bank unless the state specifically permits the use of cash. Art.13.	None.
Guarantee for contract	Optional. Art.15.	Optional. Art.15.
Choice of Law	Chinese law only.	Except for contracts on joint venture, cooperative enterprises, and development of natural resources in cooperation with foreign companies, parties may choose Chinese law *or other law* for dispute settlement. Art.5.
Breach	ECL describes ten types of contracts, ranging from sales of goods to insurance. It provides for each contract what shall constitute breach. Art.17 to 26 and Art.38 to 47.	Failure to perform or performance not in conformity with the contract is breach. Art. 18.
Self-help	Party cannot suspend its performance by stopping delivery or payment if the other party fails to fulfill its obligations. Art. 37.	Party can suspend its performance only if there is adequate evidence that the other party will default. But he must inform the other party immediately. Performance shall be resumed if the other party provides adequate assurance or guarantee. Suspension of performance without adequate evidence of the other party's default is a breach. Art.17.

Appendix 1: FECL and ECL(3)

	ECL	FECL
Damages	Damages are divided into two categories: liquidated damages (weiyuejin) which should be provided in the contract and compensatory damages (peichangjin) to be paid where liquidated damages are not sufficient to compensate the actual loss suffered by the non-breaching party. Liquidated damages are paid if one party is in breach whether or not there is a loss. Art. 37. Damages shall be paid within 10 days after the responsibility is determined. Damages shall come out of the part of post-tax profit that goes to the breaching party, not added to cost. Art.36 and 37	Damages shall equal the loss of the non-breaching party as a consequence thereof. It shall not exceed what the breaching party could have foreseen at the time the contract was made. Art.19.
Liquidated damages	Liquidated damages are enforced. There is no provision whether they will be enforced when they far exceed actual loss. If one party gives a deposit as guarantee of performance, it can not recover the deposit if it breaches the contract. If the other party is guilty of breach, he shall be entitled to recover the amount that he depoists plus an equal amount. Art.14.	Liquidated damages are permitted. However, if they far exceeds or is far less than the actual loss, the aggrieved party can petition the arbitration authority or courts to make changes. Art.20.
Penalties for breach	1) For sales contract based on the price set by the state, if the price is later adjusted by the state, the party guilty of late payment for delivery must pay either the original price or the adjusted price, whichever is higher Art. 17. 2) Breaching party may be subject to administrative penalty or criminal penalty. Art. 32.	No express provision. None.
Mitigation	No express provision.	Failure of the non-breaching party to adopt prompt measures to prevent aggravation of loss will bar him from recovery of the additional damages. Art. 23.
Force Majeure	*Force majeure* provides a ground for excuse of performance. But there is no express definition. Art. 34.	*Force majeure* means events the parties cannot foresee at the time the contract is made and the occurence and consequence of which can not be avoided or overcome. Parties may specify the events of force majeure in the contract. Art. 24.

Appendix 1: FECL and ECL(4)

	ECL	FECL
Assignment & delegation	Assignment is not expressly provided for. But it apparently falls within the purview of provisions on modification of contract. Agreement of the parties can result in modification of a contract if such a modification will not adversely affect the implementation of the state plan or national interest. Art. 27.	Agreement must be obtained. Approval by the contract supervisory authority is necessary only where the contract in question was approved when it was formed. Art. 26 & 27.
Statute of limitations	One year from the time the claimant becomes aware of infringement. Art.50.	Contracts for sale of goods: four years. Others are not provided. Art. 39.
Effect of the state plan.	Changes in or cancellation of the state plan upon which a contract is based will provide a ground for termination or modification. Art. 27.	No provision.
Effect of superventing laws	No provision.	Contracts for joint ventures, cooperative enterprises with foreign companies, and development of natural resources in cooperation with foreign enterprises will not be affected by subsequent changes in Chinese law. Art.40.
Administrative of contract	Administrative authorities and other agencies for industrial or commercial administration are empowered to supervise contracts. Banks and other financial institutions are also empowered to supervise the implementation of the contracts through accounting or financial regulations. Arts. 51 and 52.	No provision.

Appendix 2: FECL and Shenzhen FECL(1)

	Shenzhen FECL	National FECL
Scope of Application	Any contracts between domestic enterprises located in the ShenzhenSpecial Economic Zone and foreign enterprises or individuals, joint ventures, cooperative enterprises; Contracts among foreign enterprises or individuals, joint ventures, cooperative enterprises in the Shenzhen Special Economic Zone. Art. 2.	Any contracts between foreign and domestic enterprises except for those on international transportation. Art.2.
Form of Contracts	Writing is required. Art. 7 Letters, telegrams or telexes are sufficient writing Confirmation is optional. Art 7	Writing is required. Letters, telegrams or telexes can be considered as agreement. Confirmation is optional. Art. 7.
Invalid Contracts	1) Contracts violating PRC law; 2) Contracts detrimental to the Sovereignty of China 3) Contracts contrary to public or social interest; 4) Contracts induced by duress or fraud. Art 6.	1) Contracts violating PRC law; 2) Contracts contrary to public or social interest; 3) Contracts induced by duress or fraud.
Requirements respecting negotiation of contracts	Parties are required to submit to each other the following: 1) duplicate of registration; 2) certified balance sheet; 3) notarized statement of financial guarantee; 4) notarized power of attorney. Art.9 & 10.	None.
Guarantee for contract	Compulsory. Art.12 & 13.	Optional. Art. 15.
Choice of Law	No express provisions.	Except for contracts of joint venture, cooperative enterprises, and development of natural resources in cooperation with foreign companies, parties may choose a law other than Chinese law for dispute settlement. Art.5.
Breach		
Penalty for late delivery or payment	Breaching party shall pay 0.1% of the total per day. Art. 21.	Breaching party shall pay interest for delay in payment. Interest in such a situation can be provided for in contract. Art. 23.
Self-help	Party can suspend its performance if the other party fails to fulfill its obligations. Performance should be resumed if the other party provides guarantee or assurance.	Party can suspend its performance only if there is adequate evidence that the other party will default, but he must inform the other party immediately. Performance shall be resumed if the other party provides adequate assurances or a guarantee. Suspension of performance without adequate evidence of the other party's likely default is a breach. Art.17.

Appendix 2: FECL and Shenzhen FECL(2)

	Shenzhen FECL	National FECL
Damages	Breaching party shall compensate the loss of the other party. Art. 21. No provision on limit of damages.	Damages shall equal the loss of the non-breaching party as a consequence of breach. It shall not exceed that which the breaching party could have foreseen at the time the contract was made. Art.19.
Liquidated damages	Liquidated damages are permitted. If one party makes a pre-paid deposit as guarantee for performance, it cannot recover the deposit if it breaches. If the party who receives the deposit is guilty of breach, the breaching party shall pay the amount of the deposit plus additional like amount. Art. 14.	Liquidated damages are permitted. However, if they far exceed or are far less than the actual loss, the party aggrieved can petition an arbitrator or a court to make adjustment in the amount due. Art.20.
Mitigation	No express provision.	Non-breaching party shall take prompt steps to prevent aggravation of loss. Failure will bar him from recovery of the additional damages. Art 23.
Force Majeure	Force majeure principally means: 1) Serious natural disasters; 2) Wars, 3) Other irresistable incidents agreed upon in contract. Art. 24	Force majeure means events that parties cannot foresee at the time the contract is made and the occurence and consequence of which can not be avoided or overcome. Parties may specify events of force majeure in contract. Art. 24.
Assignment & delegation	Agreement of the other party and approval of relevant authorities must both be obtained. Art.28.	Agreement must be obtained. Approval by the contract supervisory authority is necessary only where the contract in question was approved when it was formed. Art. 26 & 27.
Statute of limitations	It is provided that the matter is regulated by other laws. Art. 30.	Contracts for sale of goods: four year. Others are not provided for. Art. 39.
Language of contract	If more than one language is used, the Chinese version shall prevail. Art. 40.	No provision.
Effect of supervening laws	No provision.	Contracts for joint ventures, cooperative enterprises with foreign companies, and development of natural resources in cooperation with foreign enterprises will not be affected by subsequent changes in Chinese laws. Art.40.
Administrative of contracts	Contracts shall be registered with the Administration of Industry and Commerce and the relevant revenue service. Art.31 The contract regulatory agency may supervise the implementation of contracts, mediate disputes, and impose fines. Art.32 The Bank of China may supervise contracts through regulating foreign exchange. Art. 33.	No provision.