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The Foreign Economic Contract Law of China: Cases and Analysis

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Comments Welcome

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ABSTRACT

The Foreign Economic Contract Law of China is an especially important example of contract law in a transition economy because it governs all the contracts between Chinese and Foreigners. The purpose of this research is to summarize all known FECL cases that are available to June, 1993.

Following an overview of China's contract especially FECL, the cases located through the search are summarized and analyzed by illustrating a wide range of dispute resolution processes including negotiation, mediation, arbitration, the administrative process and litigation in order to indicate that business planning and negotiation are no less important in China than elsewhere.

MANAGERIAL SUMMARY

The author was a visiting scholar at the University of Michigan Business School During her stay here, she conducted the research on China's Foreign Economic Law and wrote the article on the subject under the support provided by the William Davidson Institute, Dr.Edward A. Snyder, Director, and the Institute Research Committee, headed by Professor Scott E.Masten, and personal help and encouragement.

CONTENTS

I. INTRODUCTION

Contract law is a critical element in a country's transition from a command to a market economy. As noted in the Wall Street Journal (Oct. 21, 1991) following the selection of Professor Ronald Coase for the Nobel prize: "But with all the discussion in Bangkok and elsewhere about setting up 'market systems' in former communist lands, one thing should be kept in mind: It cannot be done without first creating a legal system that protects the right of all individuals to hold, buy and sell property and without corresponding legal protections for the contracts through which those transactions are conducted. In short, as Prof. Coase himself suggested last week, a system of contract law and the means to enforce it are fundamental."

The Foreign Economic Contract Law (FECL) of the People's Republic of China (PRC) is an especially important example of contract law in a transitional economy because it governs contracts between Chinese and outside parties. Unfortunately, examples of the impact of the FECL in business disputes are difficult to obtain because Chinese courts and arbitration tribunals usually do not publish their decisions. These decisions would be useful to instructors in developing case studies, to lawyers, economists and others conducting research on transitional economies, and to companies planning business ventures in China.

The purpose of this research is to summarize all known FECL cases that are available to date. These cases were located through an extensive computerized search of several LEXIS-NEXIS data bases, including the Asia and Pacific Rim, Law Review, and World libraries. Other resources used to locate cases include China Law and Practice (an especially useful publication), China Law Report, China Law Yearbooks (Chinese version), Chinese Law and Government, and the Journal of International Arbitration.

Following an overview of China's contract law, with special emphasis on the FECL, in Part II, the cases located through the search are summarized and analyzed in Part III. The fact patterns (including standard breach of contract as well as examples of fraud and misappropriation of intellectual property) and legal analyses in many of the cases will be familiar to readers acquainted with the Anglo-American legal system. Several cases, however, raise issues that arise less frequently under the common law, such as the role of government approval. The cases also illustrate a wide range of dispute resolution processes, including negotiation, mediation, arbitration, the administrative process, and litigation. A central theme that emerges from all of the cases is that business planning and negotiation are no less important in China than elsewhere.

Special thanks are expressed to the William Davidson Institute, Dr. Edward A. Snyder, Director, and to the Institute Research Committee, headed by Professor Scott E. Masten, for the support provided for this research. Thanks also to Professor George Siedel for his personal support and encouragement. It is hoped that this research will represent the first step in the development at the William Davidson Institute of a data base of cases from China and other transitional economies. Such a data base would be especially useful in informing future research and business activity relating to these economies.

II. THE FOREIGN ECONOMIC CONTRACT LAW

Six sources of contract law in China potentially apply to foreign businesses:

1. The Economic Contract Law of the PRC (ECL), promulgated on December 13, 1981, governs domestic contracts. The ECL affects foreign investors if they have contributed equity to the formation of a company in China that then enters into a contract with another domestic entity in China.

2. The regulations of the Shenzhen Special Economic Zone on Foreign Economic Contracts (Shenzhen FECL), promulgated on January 11, 1984 by the Guangdong Province People's Congress, focus on economic activities in the Shenzhen area.

3. The Foreign Economic Contract Law of the PRC (FECL), effective July 1, 1985, was enacted by the National People's Congress. The FECL covers general principles governing all contracts signed between Chinese and foreign parties except for international transport contracts. It thus covers a wide range of business contracts, such as international loans, sales and purchases, technology transfers, and economic cooperation. In short, the FECL applies to any economic contractual act involving a "foreign element." The usefulness of the Shenzhen FECL to companies operating in that special economic zone has largely been eclipsed by the FECL.

4. The Supreme People's Court Explanation of Several Questions concerning the Application of the FECL (the FECL Explanation), issued on October 19, 1987, attempts to resolve a number of important issues arising since the promulgation of the FECL.

5. The General Principles of Civil Law of the PRC (Civil Code), effective on January 1, 1987, was enacted by the National People's Congress. This statute represents an important development in Chinese contract law. When viewed together with the FECL and the ECL, the Civil Code provides an improved regulatory framework for contractual relationships. It is assumed that the Civil Code will apply in the event of conflict with the ECL or the FECL, although this is still an open question.

6. The United Nations Convention on Contracts for the International Sales of Goods (CISG) went into effect on January 1, 1988. Among the thirty-eight Convention signatories are China and the United States. Thus the CISG applies to contracts for the sale of goods between parties whose place of business is in the United States and China unless there is specific agreement to the contrary. However, the CISG does not cover certain types of contracts, such as those involving the sale of ships, aircraft, services, and securities.

The focus of this research is the FECL. The FECL and the FECL Explanation are reproduced in Appendixes I and II. Several sections of the Civil Code are reproduced in Appendix III because they are applicable as supplementary general law.

The cases analyzed in this report (listed in Appendix IV) are summarized and organized using the forty-three articles of the FECL as a framework. Therefore a description of several FECL provisions is necessary before turning to these cases.

The FECL consists of Seven Chapters (containing Forty-three Articles) broken down as follows: (1) General Principles (Articles 1-6), (2) Formation of Contract (Articles 7-15), (3) Performance of Contract and Liabilities for Breach of Contract (Articles 16-25), (4) Assignment of Contract (Articles 26-27), (5) Modification, Cancellation and Termination of Contract (Articles 28-36), (6) Settlement of Disputes (Articles 37-38), and (7) Supplementary Provisions (Articles 39-43).

In the first chapter, "General Principles," two issues are worth noting. First, questions arise concerning the individuals and entities that are subject to the FECL. Article 2 stipulates that the FECL applies when subjects to a contract are enterprises and other economic organizations in China on the one hand and foreign enterprises, economic organizations, or individuals on the other. When the FECL was promulgated, it was questionable whether individuals or individual households in China would be recognized as subjects to a contract. But the FECL Explanation makes it clear that foreign economic contracts include contracts between or among enterprises, economic organizations, or individuals of Hong Kong, Macao, or a foreign country and those of China. Although Taiwan is not mentioned in the Explanation, nothing implies that companies or persons from Taiwan are excluded from the category of foreign persons. And in practice, Taiwanese have not been excluded.

Sino-foreign joint ventures, Sino-foreign co-operative ventures, and foreign enterprises in China are treated as a Chinese legal person. When concluding contracts with China's domestic enterprises, they come under the ECL. Only when they conclude contracts with foreign subjects are they governed by the FECL. The FECL Explanation further states that the FECL does not apply to contracts between any combination of Chinese-foreign equity joint ventures, co-operative joint ventures, or wholly foreign-owned enterprises and Chinese enterprises or persons in China. In such cases, the ECL applies. This may be one of the most significant provisions in the FECL Explanation inasmuch as it explicitly makes many contracts signed by joint ventures in China subject to the ECL, which had been dismissed by most foreigners as being relatively unimportant to their investments in China. Interestingly, the FECL Explanation does not impose a narrower definition of foreign enterprise than the FECL. For instance, the FECL Explanation does not require an enterprise to be majority owned by foreign natural persons (or Hong Kong or Macao residents) in order to qualify as a foreign enterprise. PRC organizations therefore could incorporate a subsidiary in Hong Kong or in a foreign country and then conduct business in China to take advantage of the FECL.

The second major issue in Chapter 1 relates to choice of law. The FECL adopts choice of law principles that are accepted by many countries. They may be summarized under three headings. First, the FECL Explanation states that parties may choose either Chinese law, the laws of either Hong Kong or Macao, or the law of a foreign country. Second, when the parties have made no choice in their contract, the laws of the country that have the closest connection with the contract are applicable.

The FECL Explanation sets forth thirteen specific guidelines for courts to follow in determining the law that should govern certain types of contracts in the absence of an express choice by the parties. Third, treaties to which China is a party are given priority over China's domestic law.

The most significant problem addressed in Chapter 2 (Formation of Contract) relates to the risk of a contract becoming void. Article 8 of the FECL stipulates that a contract will be established only when it is approved by the government of the PRC, if such approval is required by the laws or administrative degrees of the PRC. The FECL Explanation in Paragraph 3 lists nine types of contracts that are void. In addition, legislation promulgated in late 1991 reiterates that, as a matter of principle, all foreign trade contracts must be negotiated and signed by an authorized trade corporation. For foreigners doing business in China, these regulations confirm the importance of determining a Chinese entity's status before entering into any kind of contract with it. Moreover, a Chinese foreign trade corporation may only sign contracts for goods within its authorized scope of business. Many cases have arisen whereby foreign companies have signed contracts with Chinese entities that were not authorized to undertake foreign trade, or for goods outside the authorized business scope of the Chinese party. Several formation of contract cases discussed later in this paper belong in this category. A foreign trader is justified in asking a Chinese partner to see its business licenses and/or other documents issued by the State Administration of Industry and Commerce. While the authorization process is still under development, the PRC's Ministry of Foreign Economic Relations and Trade has been issuing a list of companies authorized to conduct foreign trade since 1987. Foreign companies are advised to consult the list to ensure that their trading partners are properly authorized. If the foreign partner has doubts as to the authority of the Chinese party, it should consult a bilateral trade body such as the National Council for U.S.-China trade, the

Sino-British Trade Council, or the China Council for the Promotion of International Trade (CCPIT).[1]

A foreign company, when signing a trade contract with a Chinese party, also must take into consideration many other regulations. Among them are those concerning export and import licensing, customs and foreign exchange regulations, and a goods quality inspection system. Any violation may render a contract void or result in punishment for the parties involved. (See, for example, Hong Kong XXX Ltd. v. SEZ ESC on pages 44-45 and Xiamen Huazhe Development v. Shenzhen Liqun Co. on pages 22-23.) Another problem relating to formation of contract has to do with the vast majority of Chinese trade deals being carried out on the basis of standard form contracts provided by the Chinese party. These contracts often contain provisions which may prove onerous to a foreign party in the case of dispute, such as the imposition of severe penalties for the late delivery by a foreign party selling to China while requiring much less stringent delivery conditions for a Chinese entity exporting abroad. (See Hong Kong Weng Lui Trading v. Shenzhen Xianya Trading Co. Gui Zhen Food Wholesale Development on pages 37-39.) Foreign companies at the outset of negotiation would be well advised to introduce modifications into the standard form contract. On the other hand, when a draft contract is prepared by the foreign party, the Chinese side generally insists that a clause be included stating that the English and Chinese versions are equally valid and binding. The foreign party should have an experienced legal translator to review the Chinese version.

With respect to breach of contract (Chapter 3) two types are addressed in Article 18 of the FECL, namely, complete nonperformance and failure to fulfill the contract in accordance with stipulated terms. A foreign party may claim damages from a Chinese party when a contract turns out to be void as a result of the latter's failure to comply with the PRC approval procedures. But it appears that Chinese courts or arbitration

[1] Business International, January, 1988.

tribunals draw a distinction between a contract which is void and a contract which has been breached when they award damages. (See A Shenzhen Supply Company v. A Hong Kong Trading Company on pages 14-15.).

Under provisions of the FECL, damages for breach of contract are limited to actual economic loss. The FECL Explanation provides a more detailed and generous formula for calculating the amount of damages approximating the formula used in the CISG. According to the FECL Explanation, damages for breach of contract include destruction, reduction or loss of property, expenses incurred in preventing loss, and interest (lost profit) that could have been obtained had the contract been fulfilled. (See Shenzhen Overseas Goods Supply Company v. GGT International Trading Company of Hong Kong on pages 19-20.).

Nevertheless, a party is exempted from liabilities resulting from a *force majeure*. The FECL does not cover the validity in relation to state policy (unlike the ECL, which states that contracts violating the state plan are automatically invalid). A foreign company negotiating a contract that could be affected by a shift in state policy is well advised to include this possibility in the contract clauses covering *force majeures*. Internationally, government acts are generally recognized as constituting *force majeures* and, although the Chinese prefer not to spell out such recognition, they are often ready to accept such a clause.[2]

Provisions regarding modification, cancellation, and termination of contract (Chapter 5) in the FECL are quite similar to regulations contained in other countries' contract laws. However, the FECL Explanation creates a new procedure for terminating a foreign economic contract by rescission.[3] Paragraph 4 of the FECL Explanation sets forth two grounds for rescission. The first is where the contract is entered into as a result of a significant misunderstanding by one party of the contents

[2] Business International, January 1993.
[3] East Asian Executive Reports, May 15, 1988.

of the contract. The second is where the contract is manifestly inequitable. If a foreign economic contract is rescinded, such rescission applies retroactively, and the contract is deemed to have no legal force from the time of its making. However, a foreign economic contract can be rescinded only by a people's court upon one party's request; in other words, a contract cannot be rescinded by an aggrieved party without some form of judicial order or intervention.

It is not clear whether this rule is intended to empower a court to ignore a valid arbitration clause in case of rescission. The FECL stipulates that disputes arising under a foreign economic contract are to be resolved by arbitration unless (a) the contract contains no arbitration clause and (b) after the dispute arises, the parties cannot agree in writing to arbitrate. Under the Civil Code and Civil Procedure Law, and the current judicial practice, an arbitration clause is generally respected. Traditionally, the parties to a contract may not go directly to court when there is a valid arbitration clause in the contract. Therefore, it would not make sense to allow people's courts to grant rescission on the grounds of equitable issues in the first instance, if the parties have specifically agreed to arbitrate.

According to Chapter 6 of the FECL, contract disputes are to be settled through consultation, mediation, arbitration, or litigation. When consultation and mediation fail, arbitration is often the preferred alternative. The key is for companies to write into the contract a clause stipulating arbitration, the venue, and the pertinent rules. It is noteworthy that China now accepts arbitration in a third country. In 1987, China became a signatory to the United Nations International Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). China therefore is obliged to enforce arbitral awards made abroad. However, arbitration tribunals in China are gaining an increasing reputation for providing fair judgments.

Although Chinese people's courts are open to foreign disputes, cases rarely get that far. Only as a last resort are legal proceedings used in resolving disputes. Most foreign companies remain unconvinced of the quality of judgments handed down by Chinese courts. In addition, legal action in China is expensive and takes considerable time. Therefore, disputing parties usually seek a negotiated settlement.

In summary, the FECL generally was regarded as a major breakthrough in China's legal development when promulgated in 1985. While the FECL Explanation attempts to resolve a number of important issues arising since the FECL became effective, the Explanation covers only a small part of the statute, leaving many questions unanswered. Thus the Explanation simply represents the first step in transforming the FECL from a statement of general principles to a refined body of contract law in China.

Detailed implementing regulations of the FECL (see Article 42 of the FECL) promised in the late 1980s and drawing on the administrative experiences of the Ministry of Foreign Economic Relations and Trade (MOFERT) and the case-specific experiences of arbitral tribunals and the courts have yet to materialize. It is to be hoped that a refined body of Chinese economic law akin to the Uniform Commercial Code of the United States will appear in the near future, or at least that the implementing regulations of the FECL will appear soon. Obviously, both developments are awaited with great anticipation by foreign firms doing business in China and Chinese entities with foreign ties.

III. CASE STUDIES

A. Formation of Contracts

1. *A Singapore Company v. A Chinese Trade Company,* B Municipality Intermediate People's Court (1992)

In 1985, a Singapore company (the plaintiff) made several visits to China to discuss the purchase of glazed tiles with a building ceramics factory and requested help from a Chinese trading company (the defendant) in handling export procedures for the tiles. As a result, the plaintiff and the defendant signed a sales confirmation on December 12, 1985, which stipulated that the defendant would supply the plaintiff with glazed tiles of twelve specifications. On the same day the contract was signed with the plaintiff, the defendant entered into a sale and purchase contract with Ceramics Factory. This contract included the same stipulations as the contract between the plaintiff and the defendant with regard to the names, specifications and number of glazed tiles. When the plaintiff received the goods, it discovered a large number of damaged tiles. Some of the tiles were crooked and not of a consistent color and luster.

The plaintiff commissioned an inspection company in Singapore to conduct a quality inspection of the tiles. The inspection company produced a report certifying that there were certain quality problems with the goods. After negotiating without success, the Singapore company instituted proceedings against the Chinese trading company, claiming compensation for damages and economic losses as a result of the quality problems. The ceramics factory was named as a third party in the proceedings.

The court found that there were no specific provisions concerning quality in the sales confirmation. Citing Article 12 of the FECL, the court dismissed the plaintiff's claims due to inadequate grounds and insufficient evidence for its claims.

Article 12 of the FECL provides that foreign trade contracts should generally include provisions on the quality standards of the goods sold. In the present case, no such provisions were included in the contract. Moreover, according to international practice, claims for damages should be based on contractual provisions. Because such provisions did not exist in this case, the plaintiff's claims could not be established.

In case of product quality disputes, existing Chinese legislation does not include specific provisions on inspection. However, Chinese legislation requires that in the case of inspection, the inspection should not be carried out unilaterally by the buyers of the goods. In this case, Singapore company made an improper inspection, which also led to dismissal of its claims.

2. *A Shenzhen Supply Company v. A Hong Kong Trading Company* (1990)

In July, 1988, a Shenzhen supply company (the plaintiff) entered into a contract to supply talcum blocks to a Hong Kong trading company (the defendant). In order to satisfy the contract, the plaintiff signed a further contract with Dioayutai Quarry. Unfortunately the Quarry was unable to deliver the goods with the correct specifications, and worthless rubble was loaded on the defendant's vessel. When the goods ultimately arrived at the end buyer in Korea, the buyer rejected the goods, leaving the defendant with a loss. The defendant refused to pay the plaintiff for the goods. The plaintiff thereupon brought proceedings to recover the price of the goods. The defendant filed a counter-claim for the return of its deposit.

The court found that Shenzhen supply company was never authorized to deal in talcum blocks. Citing Article 11 of the FECL and Paragraph 3 (ii) of the FECL Explanation, the court held that the contract was void on *ultra vires*, grounds, ordered the plaintiff return the deposit to the defendant and awarded damages to the defendant. The defendant was also ordered to return the goods at the plaintiff's expense.

In this case, the Hong Kong trading company was not awarded damages for lost profits, as provided in Paragraph 6 (i) of the FECL Explanation. It is likely that the court drew a distinction between a void contract and a contract that has been breached. (See Paragraph 4 of the FECL Explanation.)

The case shows that foreign parties should determine whether the Chinese party with whom it concludes a foreign trade contract is properly authorized. Perhaps the easiest way to identify competent trading companies is to ask for a company profile brochure. If the company has any genuine trading power, this should be discernible from its brochure, which will outline its foreign trade corporation status and authority given to it by the government. In the present case, the Hong Kong trading company would have saved much expense and vexation if it had insisted on seeing the business license of the Chinese party before entering into the contract.

3. *Landale Development Ltd. v. Zhum Heng Development Ltd.*, District Court of Hong Kong Judge Downy (1990)

This case was an application by the PRC defendant for a stay of proceedings based on a clause calling for arbitration in Beijing. The contract in the case was a standard form contract (in both English and Chinese) printed on two sides of a single piece of paper. When the defendant faxed the contract to the plaintiff as an offer, it transmitted only the front page. Near the bottom of this page there was a clause (Clause 10) stipulating that the contract was subject to additional terms and conditions listed on the reverse side. One of these terms was a clause calling for arbitration in Beijing. The defendant argued the terms on the reverse page comprised part of the contract between the parties because they were referred to clearly in Clause 10. The plaintiff's failure to request clarification of the material was, the defendant argued, tantamount to signing a contract without reading all its terms. The defendant cited L'Estrnage v. F. Graucob Ltd.[4] and other cases to show that a signatory is bound by the provisions of a contract regardless of whether they have been read. The plaintiff

[4] See China Law and Practice, Vol. V, April 15, 1991, 19.

rejected this argument, arguing that Clause 10 was written in English only, and that it thus did not signify the intention of the parties (the defendant being Chinese).

The court found that most of the blanks in the standard form contract were filled in using English. The court concluded that English was the language of the contract and that Clause 10 reflected the intention of the parties. The court held that Clause 10 and the arbitration clause it referred were a part of the contract. Citing Section 6A of the Hong Kong Arbitration Ordinance, the court granted a stay of the proceedings.

4. *Di Mao Shopping Center v. Zhong Jin Garment Co.* (1990)

On January 10, 1988, the W computer sales department of the Di Mao Shopping Center (the plaintiff) entered into a sales contract with Zhong Jin Garment Company (the defendant) for the purchase of IBM computers. Under the contract, the defendant agreed to supply the sales department with 70 IBM 550 multifunctional computers to be delivered to Beijing. The sales department paid the defendant Rmb 2,724,600. However, the defendant only delivered 57 computers, and all the peripheral equipment, manuals, warranty cards, cables and wires were delivered five months later. Due to the delay the sales department was unable to assemble the computers for sale before a plunge occurred in the market price for computers.

The plaintiff sought to return the computers purchased by the sales department on the grounds that the defendant had breached the contract by the delay in performance. The defendant argued that the contract was effective and had already been properly executed and that the plaintiff, not being a party, had no rights under the contract. The parties then petitioned to the court.

The court found that the W Computer sales department was merely an economic entity subordinate to the plaintiff, and did not constitute a separate legal person. The court therefore allowed Di Mao Shopping Center to take over the rights and obligations of the sales department and to act as plaintiff in the case. The court also found that the defendant had acted outside its permitted scope of business by dealing in computers and held as follows:

a. the sales and purchase contract is void; and

b. the plaintiff must return to the defendant the 57 computers, with the defendant to refund to the plaintiff the purchase price of the 57 computers and pay interest at the bank rate of 0.66% per month.

The court declared the computer sales contract in this case invalid because the defendant was not authorized to deal in the sale of computers. *Ultra vires* contracts are considered "contracts in violation of government polices," and are thus invalid according to Articles 7 and 16 of the PRC, Economic Contract Law, which are mirrored in Articles 9 and 11 of the FECL.

5. *Li Fangqing and Li Cuihua v. Yunan Province Livestock Products Import/Export Company*, Kunming Intermediate People's Court (1989)

On October 31, 1987, Li Fangqing and Li Cuihua (the plaintiffs) signed a sale agreement with Yunan Province Livestock Products Import/Export Company (the defendant). The agreement specified the defendant's commitment to supply the plaintiffs with twelve million latex medical inspection gloves.

The plaintiffs stated the defendant failed to supply goods in accordance with the contract and claimed compensation for economic losses. The defendant claimed that it did not supply latex gloves because the plaintiffs had not adhered to the contractual stipulation that a letter of credit be opened in favor of the defendant two months prior to shipment.

The court held that the defendant had violated national laws because it had not been authorized to engage in latex glove operations. Therefore the contract was null and void. The court further held that the defendant bore responsibility for the invalidity of the contract and was liable for losses sustained by the plaintiffs, and bore litigation costs as well.

The present case raises two main issues: (a) How should liability for damages resulting from failure to obtain relevant government approval for a contract be allocated; and (b) what is correct method for calculating damages arising from such a failure? In relation to the first issue, the court's holding is consistent with Article 9 and 11 of the FECL and Paragraph 5 (ii) of the Explanation of the FECL. With regard to the second issue, the calculation of damages, the court held that since the contract had not been performed by either party, there were no economic losses on the part of the plaintiffs, apart from certain expenses incurred in traveling to and from Kunming for business negotiations. This decision would appear to be based on a distinction between damages recoverable in cases of invalidity and damages recoverable in cases of breach of contract. Loss of profit is recoverable in the latter cases according to Paragraph 6 of the Explanation of the FECL.

6. *Hong Kong Rongshi Engineering Company v. Shanghai Yuanyang Guesthouse Company*, Shanghai Intermediate People's Court (1989)

In 1985, Hong Kong Rongshi Engineering Co. Ltd. (the plaintiff) and Shanghai Yuanyang Guesthouse Co. Ltd (the defendant) arrived at an oral agreement whereby the plaintiff was to supply the defendant with copper rods and other urgently needed building materials. The plaintiff made eight successive shipments to Shanghai of copper rods and other materials, which were allegedly examined and accepted by the defendant.

Because Shanghai Municipal Government did not approve of the use of copper rods as ground connection materials, the rods were rendered unusable and stored in a warehouse. The defendant defaulted on its payment to the plaintiff and purported to cancel its order under the oral agreement. The plaintiff refused to accept the defendant's cancellation and thereupon took legal action against the defendant. The court held that the plaintiff had performed its contractual obligations and thus the defendant was obligated to pay for the goods received.

The main issue in this case is whether the contract was enforceable given that it was not in writing. Article 7 of the FECL and Paragraph 1(2) of the Explanation of the FECL provide that contracts shall be established after an agreement in writing has been reached. In this case, there does not appear to have been the required writing and, accordingly, the basis for enforcement of the contract by the court is not clear. The most likely basis of the decision is that the goods had been delivered and the court's decision merely reflected the transfer of value pursuant to the oral agreement (Article 106 of General Principles of Civil Law). If the goods had not yet been delivered, the plaintiff may not have been able to recover damages arising from an anticipatory breach.

7. *Shenzhen Overseas Goods Supply Company v. GGT International Trading Company of Hong Kong,* Shenzhen Municipality Intermediate People's Court (1989)

On June 12, 1988, Shenzhen Overseas Goods Supply Company (the plaintiff) signed a letter of confirmation with GGT International Trading Company of Hong Kong (the defendant) for the purchase of talcum blocks. According to the contract, the price of the goods was U.S.$48 per ton FOB Yingkuo or Dalia. The final port of destination was South Korea.

After signing the contract, the plaintiff effected the first of two shipments of talcum blocks, which were inspected and passed by the local commodity inspection office. The defendant, however, refused to pay the balance due on the goods. The Chinese party brought the case to court.

The defendant argued that the contract called for the plaintiff to provide talcum blocks from the Diaoyutai Talcum Quarry but the plaintiff substituted worthless rubble from another supplier. The defendant also argued that the inspection was not sufficient evidence that the goods conformed to the contract. Therefore the defendant made a counterclaim to recover a U.S.$4000 deposit and U.S.$176,740 economic losses.

(Because the defendant's Korean buyer rejected the goods, the defendant had to pay compensation to the Korean company.)

The court held that the plaintiff was not authorized to sell talcum blocks and therefore the contract was void. The court further found that the goods supplied by the plaintiff did not conform with the contract. Citing Articles 9 and 11 of the FECL, the court ordered that: (a) the plaintiff must pay the defendant US$129,500 as compensation; (b) the plaintiff must return Rmb 292,500 paid in advance for the goods, plus interest at the rate of 1% per month; and (c) the defendant must return the goods to the plaintiff. Costs of US$5000 were also awarded to the defendant.

This case illustrates the avoidance of a contract and the related issue of measure of damages. It is not surprising in this case that the contract was declared void because the plaintiff had not obtained an export license. Paragraph 3(vi) of the FECL Explanation provides that contracts are void if approval has not been obtained in accordance with the law. What is surprising is that the export was declared void after the shipment successfully left the PRC. Under Article 11 of the FECL if one party is responsible for a contract being void (and in the present case liability for the void contract clearly rested with the plaintiff) that party must compensate other parties for all resulting losses. In this case, damages should include the claim by the Korean party, though the judgment did not mention it.

8. *Switzerland Industrial Resources Company Inc. v. China National Technical Import/Export Corporation*, Shanghai High People's Court (1988)

In December, 1984, the Shanghai office of China National Technical Import/Export Corporation (the plaintiff) entered into a contract for the purchase of roll steel from Sun Development Corporation of the United States. Later Sun Development declared that it was unable to perform the contract and requested that the supplier be changed to Industrial Resources Company, Inc. of Switzerland (the defendant). According to the contract, the plaintiff opened a letter of credit but never received the roll steel.

The plaintiff brought the case to the Shanghai Intermediate People's Court and demanded that the defendant pay damages in respect of financial losses amounting to US $5,591,244.21. The defendant responded that the sales contract concluded between the parties contained an arbitration clause and that the Chinese courts did not have jurisdiction to hear the case.

The court found that the defendant possessed neither a steel plant nor rolled steel and the full set of documents supplied for negotiation were pure forgeries. The court, therefore, held that the defendant, through a series of fraudulent acts, used the device of a contract to defraud the plaintiff. This act constituted a tort and, therefore, the case was no longer a contractual dispute. Accordingly, the arbitration clause in the contract did not apply and, because the *locus delicti* was Shanghai, this court had jurisdiction. The court ordered the defendant to pay the plaintiff damages (including interest, business losses, and legal fees) totaling US $5,136,668.60.

The judgment was based on Article 10 of the FECL, which provides that contracts concluded by deceitful means are void. This provision is expanded in Paragraph 3 of the Explanation of the FECL. The court held that the contract in this case was void *ab initi* and therefore the arbitration clause was never binding.

The case was appealed to the Shanghai High People's Court. The appeal was rejected and the original decision was upheld. The appeal was based on the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The appellant argued that the acceptance of the case by the lower court was in violation of the Convention, which was said to be applicable to the parties in the case. The appellant relied on Article 11(3) of the Convention, which requires that the courts of a contracting state shall refer the matter in question to arbitration at the request of one of the parties where there is an agreement in writing to do so, unless such an agreement is null and void. The higher court held that the contract was void for fraud, in accordance with Article 10 of the FECL. Consequently, the agreement in writing to submit to arbitration would also be void and not within the Convention.

9. *Xiamen Huazhe Development v. Shenzhen Liqun Co. and Hong Kong Shuangdi Co.*, Zhejiang Province People's High Court (1988)

On April 2, 1987, the Xiamen and Hong Kong parties initialed an agreement to import refrigerator compressors. The Xiamen party was to place its Rmb payment in a Xiamen account for exchange to U.S. dollars. This agreement was not official because the Xiamen party did not have the authority to import products or exchange Rmb. After the parties enlisted the help of the Shenzhen party, the Xiamen party and the Shenzhen party entered into a contract under which the Shenzhen party was to supply compressors to the Xiamen party.

Because the Shenzhen party also lacked authority to import, it enlisted the help of a foreign trade company to contract with the Hong Kong party. While the above events were going on, the Hong Kong party also was negotiating with another Shenzhen company for the sale of a separate consignment of compressors. The Hong Kong party was unable to supply the goods to meet the urgent needs of the Xiamen party and it approached the other Shenzhen company to purchase some of the compressors needed for the Xiamen contract. The Xiamen party discovered that the consignee on the bill of lading was an unrelated third party and, thinking that it had been cheated, initiated proceedings in the Zhejiang Province People's High Court, claiming specific performance of the contract by the Hong Kong and Shenzhen parties, liquidated damages and compensation.

The court found that the contracts and agreements among the three parties were void because they violated certain registration regulations. The court held that the Hong Kong and Shenzhen parties must return payment for the goods; the plaintiff would be responsible for its own losses. The court cited Article 9(i) of the FECL, which stipulates that contracts that are in violation of laws, policies or plans are void.

10. *Wuhan Jute Bag Arbitration Case,* China Council for the Promotion of International Trade, Foreign Economic and Trade Arbitration Commission (1988)

In September, 1985, the applicant (the buyer) and the respondent (the seller) concluded agreements for the sale of two million jute bags and signed two sales confirmations (401 and 402) for one million pieces each. The buyer was required to open a 100 percent confirmed, irrevocable sight letter of credit. When the seller received two letters of credit, it discovered major discrepancies between the letters of credit and the provisions of the sales confirmations. The seller telexed the buyer stating that it was unable to accept the letters of credit and returned them to the opening bank. The seller, at the request of the buyer, notified the buyer of the discrepancies between the letters of credit and the sales confirmations, but the buyer did not correct the letters of credit and the seller did not dispatch the goods. As a result, neither of the two sales confirmations was performed.

The buyer applied to the Foreign Economic and Trade Arbitration Commission of the China Council for the Promotion of International Trade for arbitration, stating that the seller's unilateral return of the two letters of credit was a breach of contract. Accordingly, the buyer claimed damages from the seller for the difference between the contract price and the market price at the fixed time of delivery in batches of the two million jute bags under the two sales confirmations.

The seller responded that because there were major discrepancies between the two letters of credit and provisions of the sales confirmations, the seller was unable to dispatch the goods. Therefore liability for breach of contract lay with the buyer. The seller requested the right to preserve its claim for damages from the buyer for the losses suffered as a result of its preparation and shipments of the goods.

The seller further stated that when Confirmation 401 was sent to the buyer for signature, the buyer added a provision that the responsibility and expenses for pallet packing must be borne by the seller. The seller did not accept this provision and accordingly Confirmation 401 never resulted in a contract.

The Commission decided that a contract was formed under Confirmation 401 because the seller had already accepted *all the other terms* of this sales confirmation. However, responsibility for the failure to perform the two sales confirmations did not lie with the seller. The buyer's claim against the seller for damages was rejected. The buyer was responsible for payment of the arbitration costs.

The conclusion of the Arbitration Tribunal regarding Confirmation 401 is open to question. According to Article 7 of the FECL regarding agreements reached by telex, if one party requires the signing of a letter of confirmation, as was the situation in the present case, a contract is not formed until the letter of confirmation is signed. In this case, the buyer added in its reply to the offer a term concerning shipment in pallets, a counter-offer that the seller did not accept. Does the seller's silence constitute acceptance of the counter-offer? Though China's statutes do not cover this point, Article 18 of the CISG states that: "Silence or inactivity does not in itself amount to acceptance."

11. *A Luxurious Hotel Case*, CIETAC's Shenzhen Commission (1986)

In July, 1985, a Shenzhen group company and an international Hong Kong company signed a contract for the construction and management of a luxurious hotel in Shenzhen. Under the contract, the Hong Kong company was to be responsible for all pre-opening project planning and the management of the hotel, while the Shenzhen company was in charge of constructing the hotel.

When the Shenzhen company submitted the contract to Shenzhen Municipal Government for approval, it was not approved because the hotel industry had excess supply over demand. The Shenzhen company informed the Hong Kong company of the official decision of the authority, demanding the annulment of the contract.

After signing the contract, the Hong Kong company had launched a publicity drive for advertising the project. It refused to terminate the contract and claimed damages. Since no agreement was reached between the parties, the Hong Kong Company submitted an application for arbitration to CIETAC's Shenzhen Commission.

The Tribunal held that the contract was null and void in accordance with Chinese law. According to the rules of Shenzhen FECL, which are similar to Article 9 of FECL,[5] contracts of this kind are subject to approval by the municipal government. So the contract had no legal effect. The Shenzhen company bore the main responsibility for invalidation of the contract and paid the Hong Kong company compensation for its losses.

12. *The Transfer of Computer Technology Case* (1985)

In July, 1985, a Hong Kong electronic company (the suppliers) and a Chinese computer company (the receiver) signed a contract for the transfer of certain technology. According to the contract, the supplier agreed to provide the receiver with plans, drawings and related raw materials and spare parts for production of a certain type of computer. The receiver promised not to import similar technology or purchase similar raw material and spare parts from other companies for a ten-year period.

The contract was submitted to higher authorities for approval. The authorities rejected it on the grounds that the contract disregarded the Regulations of PRC on contracts concerning Import of Technology (May, 24, 1985), which prohibit the supplier from "restricting the receiver's freedom of choice in purchasing raw materials, spare parts or facilities from various sources."

[5] China International Economy and Trade Arbitration Commission.

The contract was void because it violated Articles 9(i) of FECL, which provides "A contract shall be void if it is contrary to the laws or the social public interest of the PRC," although the authorities made the decision by citing Articles 9(2) and 9(4) of the Regulations on contracts concerning Import of Technology.

B. Contract Performance and Liability for Breach of Contract

1. *Fung Hing Co. Ltd. v. China-Schindler Co. Ltd North Division* (1991)

On December 5, 1988, Fung Hing Co. Ltd (the plaintiff) sent to China-Schindler Co. Ltd. (the defendant) an order confirmation concerning the sale of stainless steel plates used for decorating lifts. Schindler signed and sealed the order confirmation, which provided that Fung Hing would supply 600 stainless steel plates of five types to Schindler, the total cost amounting to US $237,100, C&F Xingang, paid by letter of credit with the delivery date 45 days after receipt of the letter of credit. After signing of the order confirmation, Fung Hing signed a contract with Xing He Tokyo Corp. of Japan ordering the stainless steel plates required by Schindler and paid a deposit of Y7,500,000. Later Schindler wrote to Fung Hing asking for a reduction in the order of MS-04 stainless steel plates from 400 to 200 and also requesting a new price quotation. Fung Hing sent an order confirmation at a lower price for 200 sheets of MS-04 stainless steel to Schindler on that day, but Schindler did not confirm this order confirmation.

Fung Hing then discovered that Schindler had ordered the same goods from another company. After repeated negotiations by both parties, they failed to reach agreement and Fung Hing therefore brought suit asking Schindler to pay compensation for the loss of deposit, loss of profit and other losses resulting from the unilateral cancellation of the contract by Schindler. Schindler argued that the order confirmation lacked the legal requirements of a contract.

The court held the order confirmation fulfilled the conditions imposed by the laws of China and international customary rules for sales of goods. It constituted a binding contract capable of performance. Schindler breached the contract unilaterally, Fung Hing suffered great loss and Schindler must pay compensation. Citing Articles 7, 16, 18, 19, 31(1)(ii), 32 and 34 of the FECL and Article 147(i) of PRC, Civil Procedure law, the court decided:

a. to terminate the signed order confirmation between the parties;

b. that the defendant must compensate the plaintiff for the lost deposit, which amounted to HK $467,625 with interest; and

c. that the defendant must compensate the plaintiff for the lost profits of HK $448,648.75.

The costs of these proceedings were to be borne by the defendant.

The main points in dispute were whether the contract had been formed by the signing of an order confirmation by the defendant and whether the provision of a new price quotation impliedly canceled the contract. Since the order confirmation satisfied the requirements of the contract, and both parties had signed and sealed it, it constituted a binding contract. After the signing of the contract the plaintiff, at the request of the defendant, sent out the amended order confirmation but the defendant did not confirm it. This could not constitute a new written agreement. Therefore, the plaintiff did not alter or rescind the original contract.

2. *Hong Kong Hing Fat Trading Company v. Shenyang Pharmaceuticals and Health Food Import & Export Company,* Shenyang Municipal Intermediate People's Court (1990)

On June 15, 1988, Shenyang Pharmaceuticals (the defendant) entered into a contract for the sale of three million latex examination gloves to Hing Fat Trading Company (the plaintiff) at a price of U.S. $ 0.0623 per unit. After signing the contract, the plaintiff opened a letter of credit to the defendant. The letter of credit stipulated that the defendant must supply an inspection certificate in triplicate issued by a government agency certifying that the goods conformed to the specifications of the letter of credit and a certificate in triplicate issued by the manufacturer (the third party) attesting to the quality and quantity of the goods. This requirement was not contained in the original contract. The letter of credit also contained a provision stating that the Uniform Customs and Practice for Documentary Credits, 1983 revision, would govern. The defendant raised no objections to the letter of credit.

The defendant shipped two million gloves to Hong Kong and at the same time submitted the shipping documents to the bank according to the instructions in the letter of credit. When the goods arrived in Hong Kong, the plaintiff refused the goods because the documents supplied did not conform to the terms in the letter of credit. In addition to failing to conform to the stipulations in the letter of credit, the exporter had shipped late, which caused the value of the gloves to decrease because the demand for latex gloves on the international market had declined. The defendant expressed a willingness to share the losses caused by this drop in price, and the plaintiff accepted the goods. Following negotiation, the parties agreed to decrease the unit price for the two million gloves already delivered to U.S. $0.045. The plaintiff then paid for the goods.

The plaintiff discovered that the quality of the goods did not meet the quality standard stipulated in the manufacturer's certificate and demanded return of the goods and compensation. The defendant felt that the quality of the goods was the responsibility of the manufacturer. The plaintiff brought the case to court. The manufacturer of the goods was joined in the case as a third party.

In accordance with Articles 18 and 38 of the FECL, the court held that the manufacturer should be liable for the loss caused by the inferior quality of the goods. The defendant should bear appropriate liability, and the plaintiff should bear a certain amount of liability. The court ordered that:

a. the plaintiff must return the two million gloves directly to the manufacturer;

b. the manufacturer must pay to the plaintiff 60% of the total value of the goods; and

c. the defendant must pay the plaintiff the expenses incurred for the storage of the goods and the defendant is also responsible for the inspection fees involved in the case.

This case involved liability for the quality of goods supplied under an export contract. The court based its judgment on Articles 18 and 38 of the FECL but they are not very helpful. Article 18 merely provides that in cases of breach of contract, the injured party may take remedial action and seek damages. Article 38 provides for the right of parties to take a contract dispute to court. The citation of the two Articles, however, is enough to show that what the court had in mind was breach of contract.

The issue of breach centered around the allegation that the goods provided by the defendant did not conform to a standard recorded on the manufacturer's certificate. The certificate was required under the letter of credit opened by the buyer, but not under the sales contract. In deciding the case, the court appeared to have mistakenly relied on the terms of the letter of credit rather than the contract itself. According to international practice, the letter of credit and the contract are two separate agreements and the inconsistency between them should not affect the contract between the buyer and the seller. In the present case, it is possible that the court wrongfully saw the terms introduced unilaterally by the plaintiff in the letter of credit as an amendment of the contract, which the defendant accepted silently by raising no objection and dispatching the goods. However, even the FECL requires amendments to be in writing and, presumably, signed by both parties.

There are two quality standards involved in the case. These were an American federal government standard and a PRC enterprise standard. The goods conformed to the U.S. specifications but did not conform to the enterprise standard. By attributing liability to the defendant, the court must have relied on non-conformity with the enterprise standard. This standard should not be relevant even though it was mentioned on the manufacturer's certificate because it was not stipulated in the contract and because enterprise standards are generally not applicable to international trade contracts.[6] Article 88 of the General Principles of Civil Law, PRC, stipulates that when standards of quality are not clear in a contract, international or commonly used standards are to be used instead.

The court held the manufacturer liable to the importer. However there was no contractual relationship between these parties. The only basis for this liability could have been in tort, under General Principles of Civil Law.

3. *Huaxian Yehui Garment Factory v. Zhonglian Enterprise Trading Co.*, Guangdong People's High Court (1990)

An agreement for establishing a garment factory in Huaxian County, Guangdong was concluded on July 15, 1987. According to the agreement, the defendant/appellant (the Chinese party) was responsible for providing factory premises, labor, electricity and organization of production, and for delivering processed goods to the plaintiff/respondent (the Hong Kong party). The respondent agreed to provide equipment, raw materials and packing materials. The agreement was approved by the local government.

The respondent delivered the equipment and alleged that the company had placed an order for 250 pairs of children's trousers and shipped raw materials to the appellant. The appellant denied that it received the order and raw materials. Later the appellant entered into an agreement with another garment trading company (Yiulun) from Hong Kong. The appellant agreed to process garments for Yiulun, using the respondent's equipment to satisfy Yiulun's orders. The respondent commenced an action to restrain the appellant from using the equipment to produce garments for Yiulun.

[6] China Law and Practice, Vol. IV, December 10, 1990, 35.

The Intermediate Court found the contract was valid and held that, since there was no evidence to support the claim of the plaintiff that it had placed an order for 250 dozen garments, the plaintiff was in breach of the contract. The court also held that the defendant was wrong to have used the plaintiff's equipment to process garments for another party without permission of the plaintiff. Because there were breaches by both parties, the lower court concluded that each party should be liable for its own losses, and ordered that the defendant return to the plaintiff all equipment. Costs were divided among the parties.

The appellant appealed, claiming that it had the right to use the respondent's equipment as compensation for the respondent's earlier breach of contract in not placing orders. The respondent replied that it had delivered 250 dozen children's trousers and suspenders for trial processing after the contract took effect. There were witnesses who testified to the delivery.

The appellate court found that the order had been placed, but held that the respondent failed to supply any further materials and place further orders with the appellant, concluding that both parties were in breach of contract. The high court dismissed the appeal, citing Articles 29(1) and (2) and 31(2) of the FECL.

There was no question as to the validity of the contract in either judgment. Thus liability should have been explored in greater depth. The application of Solomon's justice by merely dividing liability equally among the parties and restoring the status quo would seem to be a misapplication of Paragraph 5(ii) and 6(i) of the Supreme Court Explanation of Several Questions Concerning the Application of the Foreign Economic Contract Law, PRC.

Paragraph 5(ii) of the Explanation provides that where both parties are at fault, each party shall bear appropriate liability. This provision gives the court great discretion in attributing liability. However, rather than attempting to attribute liability the court merely set the contract aside and ordered the return of equipment in its original condition. The decision appears to conflict with the intent of Paragraph 5(ii).

Paragraph 6(i) makes it clear that losses which are recoverable under the FECL can include lost profits. Clearly in this case there is an issue of lost profits and it is likely that, under a correct analysis of liability, one of the parties would have been entitled to such profit, in addition to recovering expenses. The court also appears to have neglected to inquire whether there were quality problems justifying suspension of the contract under Article 17 of the FECL, which provides that a party may suspend performance under a contract where there is clear evidence of breach by the other party. The lower court rejected the evidence that an initial delivery had been made by the respondent, thereby precluding any basis for allowing the respondent to invoke Article 17 of the FECL. The high court, on the other hand, found that the evidence did show a delivery of 250 sets of children's garments. The high court still neglected, however, to consider whether there were problems with quality that would justify suspension of the contract. The court may have decided that no suspension under Article 17 could have occurred because the respondent gave no notice to the appellant. Article 17 provides that the party suspending performance must notify the party in breach, who is to be given an opportunity to offer a guarantee of performance.

4. *Hong Kong Company A v. Chinese Import/Export Corporation Branch B* (1990)

In March, 1987, Hong Kong Company A (the plaintiff) and Chinese Import/Export Corporation Branch B (the defendant) entered into a sale and purchase contract pursuant to which the defendant agreed to supply aluminum window screening to the plaintiff at U.S. $10.8 per roll. After the agreement was signed, the plaintiff opened a letter of credit to the defendant and asked for the schedule for delivery. However, the defendant replied that the price stated in the contract was too low and requested that it be increased to U.S. $14.5 per roll. The plaintiff insisted on the contractual price. The defendant then told the plaintiff to cancel the letter of credit, as it would no longer perform its obligations under the contract.

The plaintiff claimed that it had already entered into another sale and purchase agreement with an Indonesian buyer. If the letter of credit was canceled, the defendant would have to compensate the plaintiff for 20% of the amount of the letter of credit. The defendant still refused to perform the contract or to pay any compensation. The plaintiff applied for arbitration.

The defendant argued that the contract was signed by an inexperienced official, who mistakenly quoted the price for steel window screening instead of that for aluminum. The defendant claimed the contract was unfair and requested that it should be either rescinded or the terms amended. The plaintiff argued that the price was agreed to by both parties and could not be unilaterally altered. Therefore the defendant should be liable for its breach of the contract.

The court decided that the contract was valid and that the defendant was liable for any losses caused by its breach of contract. Twenty percent of the amount of the letter of credit as compensation was upheld.

There was no doubt that the official was a properly-appointed representative of the defendant and was authorized to sign contracts on behalf of the corporation.. Hence the defendant was bound by the contract even if it was mistakenly executed.

5. *Liuzhou Municipal Fan Factory v. A Certain Hong Kong Electronics Company,* China Council for the Promotion of International Trade Arbitration Commission (1989).

In 1985, Liuzhou Municipal Fan Factory (the claimant) signed a lease with an investment trust company in Guangxi. The contract specified that the claimant would lease a fan production line, which would be purchased by the Guangxi investment trust company from an electronics company in Hong Kong. In 1987 the Hong Kong electronics company formally transferred possession of the production line to the Chinese side. It was of low quality and incapable of functioning properly.

Negotiations were held between the parties, who failed to resolve the dispute. The case went to arbitration.

The claimant stated the Hong Kong dealer had delivered goods that did not conform to the quantity and quality required in the contract, causing huge losses to the claimant and the Guangxi investment trust company. The claimant demanded compensation from the Hong Kong company for damages incurred. The Arbitration Commission ordered the Hong Kong dealer to compensate the claimant in full for its direct economic losses.

In this case, the claimant recovered its direct economic losses resulting from the breach of contract based on Article 18 of the FECL but, according to the Explanation of the FECL, paragraph 6 (1), the claimant could have recovered benefits including lost profits in its claim for damages.

6. *A Hong Kong Vehicle Spare Parts Company v. A Chinese Imported Vehicle Maintenance Service Center* (1990)

On June 13, 1988, a Hong Kong Vehicle Spare Parts Company (the plaintiff) and a Chinese Imported Vehicle Maintenance Service Center (the defendant) entered into a contract, pursuant to which the defendant agreed to purchase various Japanese-made vehicle spare parts, fittings and vehicle maintenance equipment from the plaintiff.

After the agreement was signed, the plaintiff informed the defendant that the goods were out of stock in Hong Kong and the price had risen. The defendant agreed that if the quality could be assured, it would accept similar products from Japan, Taiwan or Korea. The parties, however, did not reach a new agreement on the price for these products. The plaintiff delivered HK$187,569 worth of goods to the defendant. As the defendant lacked foreign exchange, it only remitted HK$91,790 to the plaintiff and an amount of HK$95,779 was left outstanding. The defendant inspected the goods and obtained a commodity inspection certificate from the Chinese Commodity

Inspection Bureau that certified that the goods were only medium quality products and that there was no label indicating the country of origin on the goods or the packaging.

The Service Center claimed compensation from the Hong Kong Company on the grounds that the disputed goods were not Japanese-made products. The Hong Kong Company rejected the Service Center's claim on the grounds that the goods had successfully passed inspection. As the Service Center continually refused to pay the outstanding sum for the goods, the Hong Kong Company applied for arbitration, claiming immediate payment of the outstanding sum of HK$95,779 plus interest, reimbursement of HK$180,000 paid as a deposit when ordering the spare parts and fittings, repayment of all expenses incurred in connection with claims against the Service Center and termination of the contract.

The Service Center argued that the plaintiff's claim for HK$95,779 was untenable because this amount was calculated on the basis of prices of genuine Japanese-made products whereas the plaintiff had delivered much cheaper non-Japanese products. Moreover, the quality of the disputed goods was not up to the standard guaranteed by the plaintiff. The defendant made various counter-claims. It demanded the plaintiff replace all the non-Japanese products with Japanese-made products or review the prices of the non-Japanese products and compensate the Service Center for it economic losses. As the defendant objected to the quality of the goods, it voluntarily sent the disputed goods to the Commodity Inspection Bureau again for examination on October 3, 1989 (fifteen months after the receipt of the goods), and the Bureau issued a Commodity Inspection Certificate stating that the parts had various quality defects. However, the plaintiff argued that the defendant was unable to prove that the goods subjected to the second commodity inspection were those originally delivered by the plaintiff. Furthermore, because the second commodity inspection took place beyond the time stipulated by the warranty, the Commodity Inspection Certificate was invalid.

The arbitration tribunal found that the defendant agreed to accept a portion of non-Japanese products, but no new agreement was reached on the price for the non-Japanese products. The defendant received invoices but never raised any objection to the countries of origin and the price of the spare parts. The tribunal also found that the defendant's failure to pay the outstanding sum constituted a breach of the contract. The defendant did not raise any objection to the quality of the disputed goods within the duration of the warranty. Therefore, the counter-claims of the defendant had no legal or evidential basis.

The arbitration tribunal ordered the defendant to pay the plaintiff the outstanding sum of HK$95,779 with interest at 7% per annum on such sum. However, the defendant should not be held responsible for the deposit paid by the plaintiff.

In this case, there are two points worth noting. First, when the plaintiff informed the defendant that the required goods were unavailable, the defendant agreed to accept similar goods but no new stipulations were made concerning the price of the similar goods and whether the defendant, by making this agreement, waived the contractual condition regarding the country of origin. By accepting the invoices and making partial payment the defendant, in fact, waived the terms concerning the origin of the goods. Second, had the defendant paid attention to the duration of the warranty for the quality of the goods, it may have received compensation.

7. *Shinsei Tsusho Co. Ltd, Japan v. Zhong Hua International Technology Development Corporation and the Beijing Jingliao Trading Company*, Beijing Municipality Intermediate People's Court (1988)

On March 25, 1985, Zhong Hua International Technology Development Corporation concluded a contract with Shinsei Tsusho for the purchase of a certain quantity of Yamaha, Loland and Casio electronic musical instruments. According to the contract, Shinsei Tsusho was to ship the instruments to Xinggang port in Tianjin.

Zhong Hua, upon receiving the shipment notice from Shinsei Tsusho, was to open an irrevocable letter of credit to the seller.

Shinsei Tsusho claimed that it had notified Zhong Hua on several occasions that the instruments were ready for shipment and urged the latter to open a letter of credit. Zhong Hua did not respond. As a result, the contract was not implemented. Shinsei Tsusho concluded an agreement with Zhong Hua to delete the arbitration clause from their contract. Shinsei Tsusho subsequently filed a suit with Beijing Municipality Intermediate People's Court.

The court found that Zhong Hua had concluded the contract with Shinsei Tsusho on behalf of Jingliao Trading Company but Jingliao was not a party to the original contract and, therefore, Zhong Hua should be liable for damages. During the course of the trial, Zhong Hua was ordered by the government to liquidate its assets. The court ruled that the liquidating committee of Zhong Hua should be responsible for damages and all litigation costs.

The court held that Zhong Hua should be liable for damages amounting to 7% of the contract price. The basis for this award was lost profit, which is recoverable under Paragraph 6(i) of the Explanation of the FECL. In accordance with Article 19 of the FECL, such a sum was a loss foreseeable by the defendant at the time the contract was executed.

8. *Hong Kong Weng Lui Trading v. Shenzhen Xianya Trading Co. Gui Zhen Food Wholehouse Department*, Guandong People's High Court (1988)

The Seller (the Hong Kong party) and the buyer (the Shenzhen party) had been doing business together since 1983. On June 14, 1985, the parties signed an agreement for purchase of a cold storage unit. Under the contract, delivery was to be made by September 14, 1985. Payment was to be made after delivery, using profits from the two companies' joint operations.

The cold storage unit was not delivered until December 4, 1985. The buyer did not object to the late delivery and paid the seller US$8,481.26. The unpaid balance was US$46,818.74. Despite repeated demands by the seller, the buyer made no additional payments. The seller sued the buyer for the outstanding amount. The buyer argued that the seller was in breach by its late delivery.

The lower court held that although the seller should bear certain responsibility for its late delivery, the buyer should bear the major responsibility for breach of the contract. Citing Article 32 (i) of the PRC, Economic Contract Law, and Article 35 (i) of the PRC, Industrial and Mining Sales Contract Regulations, the court ordered the buyer to pay the seller the outstanding purchase price plus interest and the seller paid 2% of the outstanding amount to the buyer for its own breach of the contract due to late delivery.

The buyer appealed to Guangdong Province People's High Court, which agreed with most of the findings of the lower court. However, the High Court found that the buyer had acquiesced in the late delivery by the seller through its silence, and that the payment schedule under the agreement had been unclear. The court ordered that the two parties should not pursue their claims on the matters of late delivery and late payment.

The High Court quashed the parts of the lower court's judgment concerning payment of interest and damages. The court ordered the seller to refund to the buyer the money originally paid by the buyer. The buyer was ordered to pay the seller the outstanding purchase price.

The trial court decided the case on the basis of Article 32 (i) of the PRC, Economic Contract Law, and Article 35 (i) of the PRC, Industrial and Mining Sales Contract Regulations. It is not clear why these two pieces of legislation were applied instead of the FECL, which would normally apply to contracts involving Hong Kong parties. (See Paragraph 1(iii) of the FECL Explanation.) Article 32(i) of the ECL is simply the provision for compensation for breach, which is similar to the provision for breach in Article 18 of the FECL. Article 35 (i) of the PRC, Industrial and Mining Sales Contract Regulations, stipulates that suppliers who fail to deliver goods may be required to pay a penalty. This provision is not mirrored in the FECL. In fact, the FECL allows parties to prescribe liquidated damages in a contract, although these may be modified to fit the actual amount of loss suffered. (See Paragraph 6 (ii) of the FECL Explanation.)

The High Court annulled the damages imposed by the lower court, finding that the buyer had acquiesced in the seller's breach. Acquiescence in breach is not dealt with formally in Chinese contract law. In a number of recent cases, however, Chinese courts have concluded that a long-term failure to object to a breach can affect a party's claim to compensation. (See the Small Mushrooms Case that follows.)

9. *The Small Mushrooms Case,* Guangdong People's High Court (1987)

On March 8 and April 10, 1985, Xinghua Enterprises Development Company ("Xinghua") of the Shantou SEZ and Zhongzhou Trading Company ("Zhongzhou") of Hong Kong entered into a total of three sales contracts. Under the contracts, Xinghua was to sell Zhongzhou 4,050 tons various types of mushrooms, CIF Hong Kong. The contracts stipulated that Zhongzhou was to send a representative to Jieyang County, Guangdong to inspect the quality of the goods and issue a certificate of acceptance.

Payment under the contracts was to be by letter of credit. After receiving the mushrooms, Zhongzhou was required to return the barrels containing the mushrooms to Xinghua.

After the contracts were signed, Zhongzhou opened a letter of credit in accordance with the contracts. During the period from August 19, 1985 to February 2, 1986, Xinghua delivered to Zhongzhou 1,626,378 tons of mushrooms of various specifications (packed in 42,800 mushroom barrels). Zhongzhou paid U.S. $808, 425.69

of the total price, leaving a balance of U.S. $43,560.14 outstanding. One of the above batches of mushrooms (including 50 tons of small mushrooms) was inspected by Zhongzhou, which issued a letter of acceptance to Xinghua. Later Zhongzhou discovered that the quality of some of the goods did not comply with the contract and immediately gave notice to Xinghua, requesting that it stop shipment. After negotiations with Xinghua, shipment on this batch of goods was stopped and they were returned along with some of the goods already delivered to Hong Kong for reprocessing and redelivery. Out of this batch, the 50 tons of small mushrooms were never shipped to Hong Kong. The small mushrooms were stored improperly by Xinghua at the pier in China for a long time. They spoiled, causing a loss found to amount to Rmb 74,758.50. Later, the parties entered into an agreement for the return of the mushrooms barrels, but because of a lack of coordination between the parties, the barrels were never returned to Xinghua.

Xinghua urged Zhongzhou to return the barrels many times but Zhongzhou did not comply. Xinghua commenced proceedings against Zhongzhou at Shantou Intermediate People's Court, requesting the return of the barrels, settlement of the outstanding purchase price owned by Zhongzhou, and compensation for the loss of the small mushrooms. Zhongzhou remitted the outstanding purchase price to Xinghua but argued that it had already settled the purchase price due to Xinghua, and further argued that because Xinghua had failed to obtain customs clearance for the mushroom barrels, Zhongzhou had been unable to return the barrels and had paid the charges for storage. It demanded that Xinghua pay compensation for these expenses.

The intermediate court held that the parties failed to perform the shipments and payments specified in the contract, an act of bilateral breach for which each party would be responsible for its own loss. Citing Articles 7(1), 18 and 23 of the FECL, the court ordered Zhongzhou to return the 42,800 mushroom barrels, and to pay Xinghua the interest on the delayed payment. Of Xinghua's loss of Rmb 74,758.50 from the spoiled small mushrooms, Zhongzhou was liable for Rmb 50,000, the balance to be borne by Xinghua.

Zhongzhou appealed to the Guangdong People's High Court. The high court agreed with the fact findings of the lower court but disagreed with the apportionment of liability in connection with the small mushrooms. The high court found that Xinghua should bear greater liability for the loss of the 50 tons of small mushrooms because the prices quoted in the contract were designated CIF Hong Kong. According to international practice, the court held, the seller of CIF cargo is responsible for hiring the carrier and assumes all risk with respect to the cargo before the goods pass the ship's rail at the point of shipment. Xinghua, therefore, should be primarily liable for the deterioration of the small mushrooms. The court also held, however, that Zhongzhou was partially liable, since it had inspected and accepted the small mushrooms but refused to take delivery.

This case involved the issues of breach through improper delivery and liability for improperly stored goods. The thorniest point was liability for the 50 tons of small mushrooms. The buyer issued a certificate of inspection for the small mushrooms, signaling acceptance. At that point in time, the seller would have been able to dispatch the goods CIF and the buyer would have had difficulty refusing them. Instead, however, the buyer insisted that the goods were not up to standard and the seller agreed, perhaps unwisely, to take them back for reprocessing. The seller also failed to take steps to preserve the goods while they were stored at the Chinese pier, which it had a duty to do regardless of who was liable for the goods at the time. International practice with regard to preservation of goods may be derived from the UN Convention on Contracts for the International Sale of Goods. The requirement to mitigate losses is also found in Chinese law under Article 22 of the FECL, which stipulates that the parties may not claim compensation for damages that they could have prevented. In this case, had Xinghua taken steps to prevent deterioration of the small mushrooms, it would have been justified in claiming its expenses from Zhongzhou.

It is also worth noting that while the judgment of the Intermediate Court stated that both parties were in breach of the contract, the High Court found that the contract was discharged by agreement.

10. *The Trimming Torque Wrench Case* (1987)

In October 1982, Shenyang Stochastic Instruments Factory (SSIF) concluded a trimming torque wrench technology contract with CDI Corporation of the United States. The contract provided that the American party should provide drawings and technology to SSIF without charge. SSIF undertook to keep the technology a secret. This would comprise a portion of the American party's investment. The products were to be marketed jointly, both abroad and on the domestic market. In order to ensure product quality, SSIF sent the factory deputy in charge of technology, Mr. Han, and four others to the U.S. to study for twenty days. After returning to China, Han, without authorization, resigned from his job and went to work for Shenyang Vehicular Instruments Factory (SVIF). He made use of the wrench technology which he had studied in the U.S. to produce products which were exported to Hong Kong, the Netherlands, and several places within China.

Due to the departure of Han, SSIF lost its main technological strength and could not produce its products. Therefore, it could not perform the contract. Even more serious was the fact that Han could make use of the skills he had acquired. He applied to the State Patent Bureau for registration of a technology patent and filed an opposition with the Bureau against the application by CDI for a patent in China for the "trimming torque wrench." This resulted in the American party being unable to gain approval for its patent rights in China. CDI claimed that the contract had been violated and that this was a case of divulging technological secrets.

On the basis of these facts, the American party requested the Chinese side to remedy swiftly this breach of the contract. Otherwise it would apply to a Swiss arbitration organization for arbitration, in accordance with the terms of the contract. At the same time, it declared that the contract with the Chinese party was suspended.

Liaoning Province Branch Council for the Promotion of International Trade, Legal Consultancy, handled the case. Consultancy concluded that Han had violated China's FECL and the PRC, Administration of Technology Import Contracts Regulations. Han had also violated international treaties and international customs and usage with respect of international technology transfer. Shenyang Municipal Government also took this matter very seriously. It was decided that Han should return to work at SSIF, where he would be held responsible as an individual.

The Dongling district government directed SVIF to terminate immediately production of the trimming torque wrench and to refrain from marketing the product within China and abroad. SVIF withdrew its objection from the State Patent Bureau with respect to CDI's application for a trimming torque wrench patent in China.

In the present case, SSIF could not perform the contract due to the departure of the employee Han. This would not excuse non-performance. Accordingly, under Article 18 of the FECL, CDI would have been empowered to request damages or request other reasonable remedial measures. The only remedy exercised by CDI was to declare the contract suspended in accordance with Article 17 of the FECL, which provides that a party to a contract who has confirmed evidence that the other party will not perform the contract may suspend the contract. But the term "confirmed evidence" is not defined in the FECL or in the Explanation of the FECL. Accordingly, it may have been risky for CDI to exercise this remedy because, if a court subsequently decided that there was no confirmed evidence, CDI may have been liable to SSIF for non-performance.

This case was resolved exclusively by administrative means. The Dongling district government ordered SVIF to withdraw its patent application and to refrain from producing the CDI wrench. This method should be kept in mind by joint ventures and foreign businesses when considering remedial action against state enterprises in the PRC.

C. Assignment of Contract Rights

1. *Hong Kong XXX Ltd. v. Chinese SEZ ESC*, Mou Shi Municipal Court (1985)

In December 1981, Hong Kong XXX Ltd. (the plaintiff) negotiated a contract with a commune in a Special Economic Zone for the establishment and operation of a hotel. According to the contract, the commune would provide land and the plaintiff would be responsible for constructing the hotel and arranging financing. Under the contract, no party could change the terms of the agreement or transfer his interest to a third party without the consent of the other party. Construction was completed and the business of the hotel commenced as planned. The plaintiff later transferred 80% of its interest in the hotel investment to Electrical Station Construction Office (ESC) in another province. The transfer agreement was approved by the SEZ government.

According to the agreement between the plaintiff and ESC, ESC was to pay for the 80% interest approximately one million Rmb, half of which was to be paid in Hong Kong dollars. Since ESC failed to obtain necessary foreign currency, it converted with the Bank of China half a million Rmb to 1.2 million Hong Kong dollars. The exchange rate was 39.6 Rmb for 100 $HK. When ESC remitted 600,000 $HK to XXX, the plaintiff did not accept this sum, claiming that the conversion should have been based on the state exchange rate on the day of the conversion, namely, 24.67 Rmb for 100 $HK. Accordingly, the plaintiff demanded that the defendant pay a further sum of 730,000 $HK. The parties could not reach an agreement, whereupon the plaintiff commenced proceedings against ESC.

The court held that the conversion was performed according to an internal exchange rate for use in balancing foreign exchange between domestic enterprises. According to relevant provisions, this rate is not applicable to overseas Chinese investment and foreign investment enterprises. The conversion of foreign exchange by ESC was illegal and invalid.

In addition, although the plaintiff had applied to the municipal government for approval, the commune was still unconvinced and commenced proceedings claiming damages on the grounds that the transfer by XXX of its interest in the hotel was a violation of the contract.

Numerous attempts at mediation were unsuccessful. The plaintiff proposed that the agreement for the transfer of its interest in the hotel be terminated. A mediation agreement was finally concluded between all parties pursuant to which the contract between the plaintiff and the defendant for the transfer of the interest in the hotel was to be terminated. The plaintiff was to repay the sum of money that ESC remitted to it with interest to the defendant, while the defendant was to return to the plaintiff its interest in the hotel. The court costs were to be paid by the plaintiff.

A transfer of contract rights by one party is generally not allowed under Article 26 of the FECL unless the other party consents. A complicating factor in this case was the approval of the transfer by the municipal government.

D. Modification, Cancellation and Termination of Contract

1. *The Conference Room Case*, Chongqing People's Court (1989)

A tender was opened by a party (Party A) for a seven-story construction project in Chongqing city. The contract was awarded to a construction team (party B). After signing the contract, Party A decided to alter the construction plans by adding a conference room on the roof of the 7th floor. Another party (Party C), which had lost the tender, commenced proceedings in the local court, arguing that it was unlawful for

Party B to work on the project because Party B was a Grade 3 enterprise, which can only contract construction projects of less than 8 stories. This was now an 8-story building.

The court found that the plaintiff (Party C) was a tendering party and that the defendant was a successful party in the tender. The tender did not cause any harm to Party C because it was not a qualified plaintiff, not being a party to the contract. The case was rejected and Party C was responsible for losses resulting from the cessation of work caused by the litigation.

The addition of the conference room was an amendment of the contract. According to Article 28 of the PRC, Economic Contract Law, where an alteration is made to a contract the two parties shall first agree in writing and before such an agreement is reached the original contract remains valid. In the present case, Party A had altered the detail drawing unilaterally and had failed to notify Party B. Therefore, the alteration was not part of the main contract. A similar provision in Article 32 of the FECL would apply to an alteration in a construction contract with a foreign contractor. Article 32 also requires that an alteration in a contract be agreed upon by both parties in writing.

2. *Hong Kong AAA Aluminum Factory v. BBB Industrial Company,* Shenzhen City Intermediate People's Court (1988)

BBB Industrial Company (the defendant) and Hong Kong AAA Aluminum Factory (the plaintiff) signed a compensation trade agreement for the processing of aluminum. Under the terms of contract, the two parties were to cooperate in the production of shaped aluminum for a term of five years with an annual output of 1000 tons. The plaintiff was to be responsible for supplying production equipment, which was to be paid for by the defendant by setting-off processing fees charged to the Chinese party over the course of the contract period.

The contract came into effect upon approval by the Guangdong Provincial Administration of Special Economic Zone and performance of the contract began in the following year. But production was far below the target and the plaintiff requested termination of the contract and repayment of equipment costs ahead of schedule. The defendant consented to this request.

Two years after the cooperation period began, two agreements were concluded by the parties. The first agreement provided that the defendant was to pay the plaintiff for equipment costs ahead of schedule. The second agreement provided that scrap aluminum placed in the defendant's warehouse by the plaintiff was to be made into aluminum rods by the defendant. The two agreements were not reported to the government as prescribed by Article 27 of the Shenzhen Special Economic Zone, Foreign Economic Contract Provisions.

Relying on these two agreements, the plaintiff signed a contract with a Filipino Company for the sale of aluminum rods. The plaintiff received a 30% deposit on the consignment. However, the defendant failed to deliver the aluminum rods and the plaintiff was unable to honor its agreement with the Filipino firm. As a result, the Filipino company claimed damages from the plaintiff, which in turn brought action against the defendant in Shenzhen City Intermediate People's Court.

The plaintiff requested that the defendant pay compensation with interest for losses caused by the defendant's failure to deliver the aluminum rods. In response, the defendant claimed that failure to deliver the goods on time was due to the plaintiff's failure to pay the processing charges and to supply necessary parts, and that the two later agreements were invalid because no approval had been obtained.

Although the court attributed most of responsibility for the dispute to the defendant, the court held that the plaintiff bore some responsibility. The plaintiff was persuaded to withdraw its claim for damages based on the claim of the Filipino firm, while the defendant agreed to drop its demand for processing fees. Court costs were shared equally by both parties.

The main issue in this case was the effect of the failure of the parties to obtain approval for the two agreements that altered the original contract. According to Article 27 of the Shenzhen Special Economic Zone, Foreign Contract Provisions, "A party that demands modification or cancellation of a contract shall submit an application and relevant documents to the approval authority. Before the application has been approved, the original contract continues to be valid." The two later agreements were therefore not binding. The important consequence of this conclusion is that there was no valid contractual basis for the final delivery of aluminum rods, and hence the plaintiff's claim against the defendant for damages was invalid. This decision is based on Paragraph 5 (ii) of the FECL Explanation, which states that where a contract is declared invalid due to the fault of one party that party shall be liable for damages to the other party for any resulting loss. Where both parties are at fault, the Explanation provides that each party shall bear appropriate liability. In this case, liability for failure to obtain approval for the two later agreements was split between the two parties, with the defendant held to be primarily at fault.

E. Settlement of Disputes

1. *Beijing Arbitration Award Case,* Hong Kong Supreme Court (1992)

On August 11, 1988, Shenzhen NanDa Co. Ltd. and Hong Kong FM International Ltd. signed two contracts dated August 6 and 8, 1988, pursuant to which FM International agreed to sell and Shenzhen agreed to buy a quantity of refrigerators. Both contracts were in English and contained a Hong Kong arbitration clause. On August 25, 1988 both parties signed two Chinese/English contracts dated August 6 and 8, 1988, which related to the same items as specified in the English contracts. However, the Chinese/English contracts contained an arbitration clause providing for arbitration in Beijing.

Disputes arose between two parties. Shenzhen NanDa submitted a claim to the China International Economic and Trade Arbitration Commission (CIETAC) in Beijing. FM International also made a written submission to CIETAC.

Shenzhen NanDa argued that the two English contracts were only letters of intent which lost their effect when the other Chinese/English contracts were signed and that it had only agreed to arbitration in Beijing. FM International argued that it was necessary to have a Chinese/English contract. This was the sole reason why the Chinese/English contracts were signed and Shenzhen understood that the English contracts were the binding ones.

CIETAC held that provisions of Chinese/English contracts should take precedence. Shenzhen NanDa claimed U.S. $2.76 million and was awarded U.S. $148,176. Shenzhen NanDa then initiated legal action in the Supreme Court of Hong Kong for enforcement of the arbitration award.

The court stated that Hong Kong is a party to 1985 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Permission was given to enforce this award as if it were a judgment of this court.

2. *The Pharmaceutical Supplies Case* (1990)

In May, 1987, a trading company in Shenzhen (the Shenzhen company) commissioned a Chinese company (Company B) to enter into a contract with a foreign company (Company A, the plaintiff) for the import of amino acid and Xianfeng Bisu. The conditions of the contract were C&F Shenzhen, D/P terms.

The Shenzhen company also entered into a separate agreement with Company A to directly pay Company A the amount due for the imported goods, even though the contract between Company A and Company B stipulated the terms of payment for the goods.

Company A received payment from the Shenzhen Company for amino acid that was delivered. However, following delivery of Xianfeng Bisu, the Shenzhen Company refused payment. Company A then turned to Company B for payment and was refused again. Thereupon Company A applied to the arbitration commission and claimed against Company B for the agreed price on the ground that it was stated clearly in the contract that payment was to be made on D/P terms and Company B, therefore, had an obligation to pay the purchase price.

The defendant argued that although the contract provided for payment on D/P terms, there was a separate agreement between Company A and the Shenzhen Company that Company A would be paid by other means by the Shenzhen Company. Company A asked Company B for payment only because it was not able to obtain payment from the Shenzhen Company. Accordingly, Company B argued it had no obligation to pay for the goods. Company B also argued that it had suffered economic losses and claimed against the Shenzhen company for the outstanding commission together with interest.

The Arbitration Tribunal decided to disallow Company A's claim against Company B for the purchase price. Company B's claim against the Shenzhen Company for the outstanding commission together with interest was not considered as it was outside the jurisdiction of the arbitration tribunal.

Since this contract is one between a Chinese and a foreign entity, it is governed by the "Supreme Court Explanation" (paragraph 2 (iv) of the Explanation of the FECL). In this case, the arbitration tribunal held that the means of payment used in the case were in breach of the contract signed between Company A and Company B. This breach of contract was the main ground for the refusal of the plaintiff's claims. It would seem, however, that the tribunal was harsh in regarding as a breach of the contract the failure of Company A to pass the documents required for payment through a bank in China under D/P terms. It could be argued that Company A's action was merely a failure to satisfy the conditions for payment rather than a breach.

The defendant, Company B, did not receive the amount of commission due from the Shenzhen Company and therefore requested that the Shenzhen Company be included as a third party in the case. The China International Economic and Trade Arbitration Commission Arbitration Rules make no provision for the inclusion of third parties when arbitration is already in process. However, given that arbitration tribunals are not tightly bound by procedural technicalities, as would be the case in court, the fact that there is no such provision in the Arbitration Rules should not preclude an arbitration tribunal from deciding to add a third party.

F. Other Contract Matters

1. *The Television Tube Case* (1992)

Hong Kong Company X (the plaintiff) signed a contract with Chinese company Y (the defendant) for the sale of TV tubes. Meanwhile, Company Y entered into another agreement for the sale of TV tubes to Electronic Equipment Company Z at the same price. Payment for the TV tubes was to be made directly to Company X by Company Z, while Company Y was to receive a commission from Company Z.

Company X delivered a total of 4,500 TV tubes but only received payment for 2,500 TV tubes. Accordingly, Company X filed a claim against Company Y for the remaining price of TV tubes plus interest. Company Y argued that the sale and purchase was originally negotiated between Company X and Company Z. Since Company Z did not have the right to do business with foreign parties, Company Y was merely the agent for Company Z and should not be liable to Company X for the amount due.

The Tribunal found that it could not determine from the contract whether Company Y was Company Z's agent. The relationship between Company Y and Company Z should be determined in accordance with the agreement between them and therefore was not an issue to be decided in the present case. The tribunal held Company Y liable for the unpaid TV tubes together with interest.

This case confirms that in the absence of a written agreement, the mere performance as an agent is not conclusive proof of agency. For a foreign party involved in such a transaction, it is clearly important to determine whether the Chinese parties dealt with are agents or principals, as one cannot claim from agents.

2. *Hong Kong X Teahouse v. Shenzhen Y County Workers' Culture Palace, Y County People's Court*, Shenzhen, (Reported in 1988)

On March 10, 1982, Hong Kong X Teahouse (the plaintiff) and Y County Workers' Culture Palace (the defendant) concluded an agreement for the cooperative operation of a fast shop in the Culture Palace. According to the contract the defendant was to provide land and workers and was to be responsible for organizing the construction of the shop. The plaintiff was to provide capital for construction and importing equipment and was also to provide an interest free loan as circulating funds for the shop. The agreement was approved by the Y county government. But later a state provision prohibited government organizations from engaging in commercial activities. Thus the Y county government terminated the cooperative project between the plaintiff and the defendant.

The plaintiff challenged the Y county government decision and failed to obtain approval to perform the contract. The plaintiff then sued the defendant for not performing the contract and claimed damages.

The trial court ruled that the contract was originally valid but became void after the decision of the Y County government. Citing Article 2(ii) of the Sino-Foreign Equity Joint Law and Article 16 of the Economic Contract Law, the court concluded that the defendant should repay the plaintiff the latter's remittance, and that the plaintiff should repay the defendant for advance payments for transportation and boarding. When the plaintiff appealed the decision of the trial court, the appellate court upheld the decision.

This case was decided before the introduction of the FECL. However, the case was published in China in 1988. The case may therefore be regarded as having some instructive value.

The case is an example of a change in government policy which affected, retroactively, the validity of a joint venture contract. The case is also an example of a contract being declared void, which resulted in the parties being ordered to return payments derived under the contract. This form of restitution is provided for in Article 16 of the Economic Contract Law. While it is not provided for in the FECL, there have been cases using similar approaches in foreign-related contract cases. In one case, for example, the central government terminated a contract as a matter of policy and the contractor, Hopewell Holdings, was compensated for the termination in an attempt to restore its precontractual position.[7]

[7] China Law and Practice, Vol. II, Oct. 31, 1988, 32.

Appendix I

Foreign Economic Contract Law of P.R. China

(effective July 1, 1985)

Chapter 1. General Provisions

Article 1. This law is enacted to protect the legitimate rights and interests of parties to economic contracts for deals involving foreign businesses, and to promote our country's foreign economic relations.

Article 2. This law applies to economic contracts (hereinafter referred to as contracts) between enterprises, or other economic institutions, of the PRC and their foreign counterparts or individuals. However, international transport contracts shall be excluded.

Article 3. In making contracts, the principle of equality and mutual benefit, and of reaching unanimity through consultation shall be followed.

Article 4. In making contracts, the laws of the PRC shall be observed, and its social and public welfare shall not be harmed.

Article 5. The parties to a contract may seek settlement to disputes in accordance with laws of their choosing applicable to such disputes. If the parties make no such choice, the law of the country most closely related to the contract shall apply. Contracts for joint ventures, cooperative management, and cooperative prospecting and development of natural resources, operating within the boundaries of the PRC, are subject to the laws of the PRC.

In the absence of relevant stipulations in the laws of the PRC, international norms shall apply.

Article 6. If the relevant laws of the PRC conflict with international treaties to which the PRC is a signatory or a party, the international treaty stipulations shall apply. However, articles to which the PRC has declared reservations shall be excluded.

Chapter 2. The Making of Contracts

Article 7. A contract will be established when the parties reach agreement on the articles in writing and sign their names. If an agreement is reached through letters, cables, or telexes, the contract will be established only when a letter of affirmation is signed, provided a party to the contract requests the signing of such a letter.

A contract will be established only when it is approved by the government of the PRC if such an approval is required by the laws or administrative decrees of the PRC.

Article 8. The Appendix to a contract is a component of the contract.

Article 9. A Contract that contradicts the laws of the PRC or its social or public welfare is invalid.

The validity of a contract will not be affected if the articles of the contract contradicting the laws of the PRC or its social or public welfare are removed or corrected through consultation by the parties.

Article 10. A contract is invalid if it is established by means of deception or coercion.

Article 11. A party to a contract responsible for the invalidation of the contract has the obligation to compensate the other party for the losses resulting from the invalidation of the contract.

Article 12. In general, a contract shall contain the following provisions: 1) titles or names, nationalities, and addresses of main offices or residences of the parties involved; 2) date and place the contract was signed; 3) type of contract, and category and scope of the contract objectives; 4) technical terms, quality, standards, specifications, and number of contract objectives; 5) time limit, place, and method for fulfilling the contract; 6) price conditions, sum of payment, method of payment, and various additional expenses; 7) transferability of the contract and conditions for transfer; 8) compensation and other responsibilities for violating the contract; 9) ways of solving contract disputes; and 10) the language used in the contract and its effectiveness.

Article 13. The parties to a contract must agree on a limit to the risks that are involved in fulfilling the contract objectives. When necessary, they should agree on the scope of insurance for the contract objectives.

Article 14. When a contract requires continuous fulfillment over a long period, the parties involved should agree on the term of validity. They may also agree on conditions for prolonging or terminating the period of validity.

Article 15. The contracting parties may agree on a guarantor. The guarantor shall be responsible for fulfillment of responsibilities that have been agreed on.

Chapter 3. Fulfillment of Contracts and Responsibility for Violating Contracts

Article 16. When a contract is established in accordance with the law, it shall be legally binding. The parties involved should fulfill the obligations of the contract. Neither side shall make unauthorized changes to or terminate the contract.

Article 17. When one party had concrete proof that the other party has failed to fulfill a contract, the former may temporarily suspend fulfilling the contract but must promptly inform the other party of its action. But when the other party provides full guarantee that it will fulfill the contract, the former should fulfill the contract. Without concrete proof that the other party has failed to fulfill the contract the party that suspends fulfilling a contract should be held responsible for breaching its duty under the contract.

Article 18. When one party fails to fulfill a contract or fails to meet the conditions agreed on for fulfilling a contract, it will have violated the contract, and the other party will have the right to ask the former to compensate for the loss suffered or to take other remedial measures. If the remedial measures are not sufficient to compensate for the loss suffered by the other party, the other party may ask for further compensation for its loss.

Article 19. The compensation made by the party that violates a contract should equal the losses suffered by the other party, but should not exceed the possible loss anticipated at the time the contract was signed should one party violate the contract.

Article 20. The contracting parties may agree in the contract on the amount of compensation one party should pay the other if the former should violate the contract; or they may agree on a method for calculating the amount of compensation for the loss caused by one party which violates the contract.

The amount of payment for violation agreed upon in the contract should be regarded as the compensation for the loss caused by the party violating the contract. However, when the amount of payment for violation is too high or too low for the loss caused by the violator of the contract, either party may appeal to an arbitration agency or a court of law for an appropriate reduction or increase of the amount.

Article 22. When one party suffers a loss because the other party fails to fulfill a contract, the former should promptly take proper measures to prevent the loss from increasing. When the former fails to do so, it has no right to ask for compensation for the increased portion of the loss.

Article 21. When both parties violate a contract, they should both share the responsibility.

Article 23. When one party fails to make payments or pay other additional expenses on time as agreed upon in a contract, the other party has the right to ask the former to pay interest on the delayed payments. The methods for calculating interest payments may be agreed upon in the contract.

Article 24. The parties concerned shall be exempted from all or part of the responsibilities for failure to fulfill all or part of the contract obligations if the failure is caused by a *force majeure.*

If one party fails to fulfill the contract within the prescribed time due to a *force majeure,* it shall be exempted from the responsibilities for the delay during the period when the effects of the aftermath of the *force majeure* continue.

A *force majeure* is an event that cannot be anticipated at the time of signing of the contract by the parties concerned, an event of which the occurrence and aftermath are neither avoidable nor surmountable.

The limits of a *force majeure* may be defined in the contract.

Article 25. If one party cannot fulfill all or part of the contract obligations due to a *force majeure,* it shall inform the other party in good time to reduce any possible loss to the latter, and it shall produce, within a reasonable time, proof supplied by the proper authorities.

Chapter 4. Transfer of Contract

Article 26. If one party wants to transfer all or part of the contract rights and obligations to a third party, it must obtain the consent of the other party.

Article 27. If a contract was signed with the approval of a state organ as required by the law or administrative regulations of the PRC, the transfer of its rights and obligations shall be approved by the organ that approved its signing. An exception is a contract signed with state approval that contains an otherwise clause or clauses to the contrary.

Chapter 5. Changes, Discontinuance and Termination of Contract

Article 28. Contract terms may be changed after the parties concerned, through consultation, agree to the change.

Article 29. One party has the right to inform the other party to discontinue the contract if any of the following situations exist: 1) The other party's violation of the contract has seriously affected the economic interests anticipated at the time of the signing of the contract; 2) the other party has failed to fulfill the contract within the originally prescribed time, and fails to fulfill the contract again within a reasonably extended period allowed; 3) none of the contract obligations can be fulfilled due to a *force majeure*; or 4) the conditions set in the contract for its discontinuance have appeared.

Article 30. The stipulations set in Article 29 may be applied to discontinue a part or parts of a contract if the contract contains several parts which are independent of each other.

Article 31. The contract is terminated if any of the following situations exist: 1) The contract had been fulfilled according to the prescribed terms; 2) an arbitration body or court has ruled for termination of the contract; or 3) both parties have agreed, through consultation, to terminate the contract.

Article 32. The notice or agreement on changes in or discontinuance of a contract shall be in writing.

Article 33. If a contract was signed with the approval of a state organ as required by the law or administrative regulations of the PRC, any major changes in it shall be approved by the organ that approved its signing, and the discontinuance of it shall be reported to the organ that approved its signing for record purposes.

Article 34. The change, discontinuance, or termination of a contract does not affect the right of one party to demand compensation for loss from the other party.

Article 35. The terms set for settling disputes in the contract shall remain valid after the discontinuance or termination of the contract.

Article 36. The terms for settling accounts and checking up on assets set in the contract shall remain valid after the discontinuance or termination of the contract.

Chapter 6. Settlement of Disputes

Article 37. In the case of a dispute over the contract, the parties concerned shall do everything possible to settle it through consultation or through mediation by a third party.

If the parties do not want to settle their dispute through consultation or third-party mediation, or the consultation or mediation fails, they may submit the case to Chinese or other arbitration bodies according to related terms in the contract or according to a writing agreement on arbitration reached after the dispute occurs.

Article 38. The parties concerned may bring their dispute case to the People's court if no arbitration clauses are included in the contract and they fail to reach a written agreement on arbitration after the dispute arises.

Chapter 7. Supplementary Articles

Article 39. The deadline for submitting a case of dispute over a commodity purchase or sales contract to a court or arbitration body shall be four years, beginning on the day when the part concerned knows, or should know, that its rights and interests are violated. The deadline for submitting cases of dispute over other contracts to a court or an arbitration body shall be prescribed by law.

Article 40. The contracts for Chinese-foreign joint ventures, Chinese-foreign cooperative enterprises, or Chinese-foreign cooperation in exploration and development of natural resources, which are executed in the PRC and approved by state organs, may continue to be fulfilled according to the contract terms in spite of new legal provisions.

Article 41. This law may be applied to contracts signed before it is put in force, if the parties concerned reach mutual consent through consultation.

Article 42. Based on this law, the State Council shall formulate rules for the implementation of this law.

Article 43. This law come into force on July 1, 1985.

Appendix II

Supreme People's Court

Explanation of Several Questions Concerning the Application of the Foreign Economic Contract Law

(Issued by Circular on October 19, 1987, to regional People's Courts at all levels, all Military Courts, all Intermediate and Basic Rail Transportation Courts and all Maritime Courts)

1. Concerning the question of the applicability of the Foreign Economic Contract Law

(1) The Foreign Economic Contract Law applies to economic contracts concluded between enterprises or other economic organizations of our country and enterprises, other economic organizations or individuals of foreign countries; including such contracts as contracts for the sale of goods, equity joint venture contracts, cooperative joint venture contracts, contracts for cooperative exploration and exploitation of natural resources, loan agreements, leasing agreements, technology transfer contracts, engineering project contracts, contracts for the supply of complete sets of equipment, processing contracts, service contracts, compensation trade contracts, technological consultancy contracts, guarantee agreements, insurance contracts, bailment contracts and agency contracts. However, international maritime transportation contracts, international air transportation contracts, international rail transportation contracts and international bimodal transportation contracts are excluded.

(2) The Foreign Economic Contract Law may also apply to the above mentioned contracts concluded between enterprises, other economic organizations and individuals from Hong Kong and Macao and domestic economic organizations as well as contracts concluded as between foreign enterprises, other economic organizations and individuals, as between Hong Kong and Macao enterprises, other economic organizations and individuals and between foreign enterprises, other economic organizations or individuals and Hong Kong or Macao enterprises, other economic organizations or individuals where such contracts are concluded or to be performed within Chinese territory.

(3) Contracts concluded as between Sino-foreign equity joint ventures, Sino-foreign cooperative joint ventures and wholly owned foreign enterprises established within Chinese territory and contracts concluded between those enterprises and other enterprises, economic organizations and individuals of this country shall not apply the Foreign Economic Contract Law, but shall apply the PRC, Economic Contract Law.

2. Concerning the question of governing law in Foreign Economic Contract Law disputes

(1) The phrase, "contractual disputes", as used in Article 5 of the Foreign Economic Contract Law should be understood in a broad sense. All disputes between the parties are included such as those involving the formation of contracts, the time when contracts were formed, the interpretation of the terms of contracts, performance of contracts, liability for breach of contract as well as alteration, suspension, assignment, recession and termination of contracts.

(2) Where the parties have already selected the governing law at the time of concluding the contract or after the occurrence of a dispute, the People's Court trying the case shall apply the law which the parties have selected.

The parties may select as their governing law Chinese law, the law of Hong Kong or Macao or foreign law. However, the parties' selection must be unanimous and express.

(3) The governing law of Sino-foreign equity joint venture contracts, Sino-foreign cooperative joint venture contracts and Sino-foreign joint exploration and exploitation of natural resources contracts which are to be performed within Chinese territory must be Chinese law. Contractual clauses in which the parties select a foreign governing law shall be void.

(4) Where the parties have not selected the governing law of the contract either at the time of concluding the contract or after the dispute has arisen, after the People's Courts have accepted the case, they shall permit the parties to make a selection before the hearing commences.

Where the parties still cannot reach unanimity on a selection, the People's Courts shall determine the proper law of the contract according to the closest connection test.

(5) Where the parties agree on the governing law or where the People's Courts determine the proper law of the contract according to the closest connection test, such law shall be the current substantive law and shall not include rules concerning the law of conflicts or procedural law.

(6) Where the parties have not selected a governing law, in normal conditions, the proper law of the contract as determined by the People's Courts according to the closest connection test for the following types of contract shall be as follows:

i. Contracts for the international sale of goods shall apply the law of the place where the seller had its place of business at the time of concluding the contract. If the contract was negotiated and concluded at the buyer's place of business or where the terms of the contract are mainly proposed by the buyer and the contract was concluded pursuant to a tender invitation made by the buyer, or where the contract clearly stipulates that the seller must deliver goods to the place where the buyer has its place of business, the law of the place where the buyer had its place of business at the time of concluding the contract shall be applied.

ii. Bank loans or guarantee agreements shall apply the law of the place where the lending bank or the guaranteeing bank has its place of business.

iii. Insurance contracts shall apply the law of the place where the insurer has its place of business.

iv. Processing contracts shall apply the law of the place where the contractor has its place of business.

v. Technology transfer contracts shall apply the law of the place where the recipient has its place of business.

vi. Engineering project contracts shall apply the law of the place of the engineering project.

vii. Technological consultancy or design contracts shall apply the law of the place where the principal has its place of business.

viii. Service contracts shall apply the law of the place where the service is to be performed.

ix. Contracts for the supply of complete sets of equipment shall apply the law of the place of installation and operation of such equipment.

x. Agency contracts shall apply the law of the place where the agent has its place of business.

xi. Contracts for leasing, purchasing or mortgaging immovable property shall apply the law of the place of the immovable property.

xii. Leasing agreements in respect to movable property shall apply the law of the place where the lessor has its place of business

xiii. Storage bailment contracts shall apply the law of the place where the storage bailee has its place of business.

However, where the contract clearly has a closer relationship with the law of another country or region, the People's Courts shall use such other law as the basis for dealing with contractual dispute.

(7) Where a party has more than one place of business, the place which has the closest connection with the contract shall be applied. Where the party has no place of business, his domicile or residence shall be regarded as his place of business.

(8) International treaties which China has concluded or in which China participates shall be applied in preference to dissimilar provisions of the Foreign Economic Contract Law or other Chinese law relating to foreign economic contracts, except for clauses to which China has declared a reservation.

(9) Where the proper law of the contract is Chinese law and where Chinese law does not provide for issues in dispute between the parties to the contract, international custom may be applied.

(10) Where the proper law of the contract is foreign law and where the application of such law violates the basic principles of Chinese law or the public interest of China, such law shall not be applied and corresponding Chinese law shall be applied.

(11) Where the proper law of the contract is foreign law and where the People's Courts cannot ascertain such law, investigation may be conducted through the following means:

i. submissions of the parties;
ii. submissions of Chinese consular or diplomatic officials in that (foreign) country;
iii. submissions of consular or diplomatic officials of that (foreign) country stationed in China; or
iv. submissions of Chinese or foreign legal specialists.

Where the foreign law cannot be ascertained by the above-mentioned means, corresponding Chinese law may be applied.

3. Concerning the question of confirming void foreign economic contracts

Foreign economic contracts shall be declared void in the following cases:

i. where the parties to contracts do not posses capacity to contract;
ii. where the Chinese party has not received authority from state authorities to engage in foreign trade;

iii. where the conclusion of the contract by the Chinese party is *ultra vires;*

iv. where contracts concluded by agents in the name of their principals and where such agents do not have authority to act as agent, act in excess of authority or where such authority has been terminated, if the principal does not thereafter ratify the act, except where the principal is aware of the above-mentioned circumstances but fails to issue promptly a disclaimer;

v. where contracts are concluded other than in written form;

vi. contracts for which approval has not been obtained, where Chinese law and administrative legislation require the granting of approval by state authorities; or important alterations or transferring of rights or obligations without the approval of the original approving authority;

vii. contracts concluded whereby one party intentionally makes false representations, suppresses the truth or employs other deceptive means, leading the other party into misapprehension; or compelling the conclusion of contracts by adopting coercive means which involve threatening to cause economic loss or other loss to the other party; or concluding contracts under iniquitous circumstances by taking advantage of the compromising position of a party and compelling such party to act against his own volition;

viii. contracts which harm the interests of the state, the public or third parties, concluded with the duplicity of the parities or contracts concluded by using legitimate forms to conceal illegal objectives.

ix. where the contents of contracts violate basic principles of Chinese law or harm the public interest.

4. Concerning the question of setting aside contracts

In any of the following situations, a party may apply to the People's Court to set aside the contract: where,

(1) the conclusion of the contract is based on a major mistake as to the contents of the contract;

(2) the contract is manifestly unfair.

Contracts which have been set aside are void *ab initio*.

5. Concerning the question of dealing with contracts which have been declared void or which have been set aside

(1) Where a part of the contract is void and where such part does not affect the validity of other parts of the contract, such other parts shall remain valid. Where the parties to the contract agree to remove (the offending clauses) or amend the contract, the validity of the contract shall not be affected.

(2) Where the contract has been confirmed void or has been set aside due to the fault of one of the parties, such party shall be liable to pay damages to the other party for loss suffered from the avoidance or setting side of the contract. Where both parties are at fault in respect of a contract which is void or has been set aside, each party shall bear appropriate liability.

(3) Where the parties are guilty of duplicity and sign foreign economic contracts to conduct activities which violate state law or harm the public interest or which harm the interests of the state or third parties, in additional to confirming such contracts void, unlawfully obtained property shall be handed

over to the state or returned to third parties and, according to the seriousness of the circumstances and in accordance with the law, a warning may be given, or a fine or a period of detention may be imposed.

Where an economic crime has been discovered, the matter shall be handed over to the public security and procuratorial authorities.

6. Concerning the question of liability for breaching economic contracts

(1) Where a party to the contract does not perform its obligations or does not perform such obligations in accordance with the contract, apart from taking other remedial measures or where the contract provides otherwise, damages which the party in breach shall pay to the other party damages in respect of property which is damaged, short delivered or destroyed and expenses incurred in relation to mitigating or recovering from such loss, as well as the benefits which could have been obtained if the contract were performed (in contracts for the international sale of goods, such benefit is the profit). However, such damages may not exceed the losses resulting from a breach of contract which the party in breach should have foreseen at the time of concluding the contract..

(2) Liquidated damages as provided for by the parties in the contract are a pre estimate of the sum to be compensated. Where one party to the contract breaches the contract, it shall pay liquidated damages as agreed to the other party. At the instance of a party, where liquidated damages are higher or lower than the losses resulting from the breach of contract, the People's Courts may exercise its discretion and grant an appropriate increase or decrease in the quantum of damages.

Appendix III

General Principles of Civil Law of
The People's Republic of China

(effective on January 1, 1987)

Selected Articles

Chapter 1. Basic Principles

Article 1. In conformity with the need for development of socialist modernization in accordance with the Constitution and the actual situation of the People's Republic of China, and based on a summary and analysis of the practical experience in civil activities, this law is enacted to protect the lawful civil rights and interest of citizens and legal persons, and to regulate correctly civil relations.

Article 2. The civil law of the People's Republic of China regulates property relations and personal relations between subjects of equal status--between citizens, between legal persons, and between citizens and legal persons.

Article 3. In civil activities, the position of the parties are equal.

Article 4. Civil activities must be carried out in accordance with the principles of voluntariness, fairness, exchange of equivalent values, and good faith.

Article 5. The lawful civil rights and interests of citizens and legal persons are protected by law; no organization or individual may violate those rights and interests.

Article 6. Civil activities must be in conformity with the law; where there is no provision of law, activities must be in conformity with state policy.

Article 7. Civil activities must be in accordance with social morality. They must not harm the public interest, undermine the state economic plan, or disrupt the economic order.

Article 8. The law of the People's Republic of China applies to civil activities within the territory of the People's Republic of China, unless the law provides otherwise.

The provisions of the present law concerning citizens apply to foreigners and stateless persons within the territory of the People's Republic of China, unless the law provides otherwise.

* * *

Chapter 4. Civil Legal Acts and Agency

Section 1. Civil Legal Acts

Article 54. Civil legal acts are lawful acts by which citizens or legal persons establish, modify, or terminate civil rights and duties.

Article 55. A civil act must satisfy the following conditions:

1. The person performing the act has the appropriate competence;
2. The real intent is expressed;
3. There is no violation of the law or the public interest.

Article 56. Civil legal acts may be in oral or written form, or in any other form. Where the law requires a specific form, the provision of the law must be followed.

Article 57. Civil legal acts have legal force from the time they occur. Unless in accordance with a provision of law, or the agreement of the other party has been obtained, the person who performed the act may not himself modify or revoke it.

Article 58. The following civil acts are void:

1. One performed by a person who is incompetent;
2. One performed by a person with limited competence who according to law may not independently perform such an act;
3. One performed under circumstances where one party, by using deceit or duress or by taking advantage of the other party's distress, causes the other party to act contrary to his real intent;
4. One which involves maliciously conspiring to injure the interest of the state, of a collective, or of a third party;
5. One which violates the law or the public interest;
6. Economic contracts which violate the state mandatory plan;
7. One which uses a lawful form to conceal an illegal purpose.

From the time it occurs, a void civil act has no effect.

Article 59. A party has the right to request the People's Court or an arbitral organ to modify or rescind the following civil rights:

1. One where the person performing it was under a significant misconception as to the contents of the act;
2. One which is obviously unfair.

A rescinded civil act is void from the time when it occurred.

Article 60. Where the invalidity of a part of a civil act does not affect the validity of the other parts, the other parts remain valid.

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Chapter 5. Civil Rights

Section 2. Obligations

Article 84. An obligation is a relationship of specific rights and duties between parties, arising either from terms of a contract or from a provision of law. The one that enjoys a right is the obligee and the one that bears the duty is the obligor.

The obligee has the right to demand that the obligor perform his duty according to the terms of the contract or the provision of law.

Article 85. A contract is an agreement whereby parties establish, modify, or terminate civil relationships. Contracts formed in accordance with law are protected by law.

Article 86. Where there are two or more obligors, rights are enjoyed in proportion to fixed shares. When there are two or more obligors, the duty is borne according to fixed shares.

Article 87. Where there are on one side two or more obligees or obligors, each obligee may, in accordance with provisions of law or the agreement of the parties, demand that the obligor perform the duty; each obligor with a joint duty is obliged to satisfy the entire duty under the obligation; the person who performs the duty has a right to demand that any other joint obligor reimburse him in the amount of the share for which such joint obligor was obligated.

Article 88. Parties to a contract must fully perform their duties in accordance with the contract.

Where the terms of a contract relating to quality, duration, place, or price are not clear and definite, and those cannot be determined from the content of related provisions of the contract, or the parties cannot reach agreement through consultations, the following provisions apply:

1. Where quality requirements are not clear and definite, performance is according to the state standard; where there is no state standard, according to the usual standard.
2. Where the time for performance is not clear and definite, an obligor may perform his duty to the obligee at any time, and an obligee may also at any time demand that the obligor perform his duty, but in both situations a party must afford the other party the time necessary to prepare for performance.

3. Where the place of performance is not clear and definite, payment in cash is made at the location of the recipient; other obligations are performed at the location of the obligor.
4. Where the price provision is not clear and definite, performance is according to the state price; if there is no state price, performance is made with reference to the market price of similar products or to the standard remuneration for similar services.

Where a contract does not provide who has the right to apply for a patent, the party who brought the invention to completion has the right to apply.

Where a contract does not provide who has the right to utilize the fruits of scientific and technological research, all parties to the contract have the right to use them.

Article 89. In accordance with provisions of the law or the agreement of the parties the following means may be adopted to assure the performance of obligations:

1. A guarantees to the obligee that the obligor will perform the obligation; where the obligor does not perform, then according to the agreement,the guarantor performs or is jointly liable; after a guarantor performs the obligation, he is entitled to seek compensation from the obligor.
2. An obligor or third party may offer certain property as a pledge. Where the obligor does not perform the obligation, the obligee is entitled in accordance with the provisions of the law to value the pledged property in cash and credit it against the obligation, or sell the pledged property and obtain compensation by priority right from the proceeds.
3. A party may within the limits provided by law give the other party a deposit. After the obligor performs the obligation, the deposit must be

deducted from the price or returned. Where the party who gives the deposit does not perform the obligation, he does not have a right to ask for the return of the deposit; if the party who receives the deposit does not perform the obligation, he must return the deposit plus an equal amount.

4. Where one party is in possession of the property of the other pursuant to a provision of a contract, the possessor may, if the other party fails to pay within the agreed time what he is obligated to pay, retain the property, and in accordance with provisions of the law value the retained property in cash and credit it against the obligation or sell the retained property and obtain compensation by priority right from the proceeds.

Article 90. A lawful loan relationship is protected by law.

Article 91. Where one party to a contract is about to make a partial or complete transfer to a third party of his contractual rights or obligation, he must obtain agreement from the other party; he must in no way seek to profit from the transfer. Where according to law a contract must be approved by the state, approval by the original approving agency is needed, but not if the law or the original contract provides otherwise.

Article 92. Where improper benefit is obtained without lawful grounds, resulting in loss to another party, the improper benefit obtained must be returned to the person who suffered the loss.

Article 93. Where without legal or contractual obligation one provides care or services to avoid harm to an interest of another, he has a right to demand that the person who received a benefit reimburse him for the necessary expenses incurred.

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Chapter 6. Civil Liability

Section 2. Civil Liability for Breach of Contract

Article 111. Where one party fails to perform his contractual duty, or his performance of his contractual duty is not in accordance with the agreed terms, the other party has a right to demand performance, or the taking of measures to correct the defective performance, and has the right to demand compensation for loss.

Article 112. The liability for compensation of a party who breaches a contract must be equal to the loss the other party incurred as a result of the breach.

Parties may provide in a contract that when a party breaches a contract he pays to the other side a certain sum of money for the breach; they can also provide in the contract the method of calculation of damages caused by a breach.

Article 113. Where both parties have breached a contract, it is necessary to determine separately the amount of civil liability each should bear.

Article 114. A party that sustains a loss due to breach of contract by the other party must promptly take measures to prevent an increase in the extent of the loss. If measures are not taken promptly to prevent an increase in the extent of the loss, the party does not have a right to demand compensation for the resulting increase.

Article 115. The modification or termination of a contract does not affect the right of a party to claim compensation for losses.

Article 116. Where the cause of a party's inability to perform its contractual duty is its supervisory organization, the party must, in accordance with what is agreed in the contract, pay compensation to the other party or take measures to correct the defective performance; the supervisory organization is then responsible for dealing with the loss that the party sustained as a result.

* * *

Chapter 8. Application of Law to Foreign Civil Relationships

Article 142. The law to be applied in foreign civil relationships is determined in accordance with the provisions of this chapter.

Where an international treaty that the People's Republic of China has concluded or participates in contains a provision which differs from the civil law of the People's Republic of China, the provision in the international treaty applies, except for an article as to which the People's Republic of China has declared a reservation.

Where the law of the People's Republic of China or international treaties which the People's Republic of China has concluded or participates in do not contain a relevant provision, international custom may be applied.

Article 143. Where a citizen of the People's Republic of China is residing abroad permanently, in determining his competence to perform civil acts the law of his permanent residence may be applied.

Article 144. In determining ownership of immovable property, the law of the place where the property is located applies.

Article 145. The parties to a foreign contract may choose the law applicable to the settlement of the disputes arising from the contract, unless the law provides otherwise.

Where the parties to a foreign contract have not made a choice, the law of the county which has the closest connection with the contract applies.

Article 146. In regard to compensation for losses caused by a tortious act, the law of the place where the tortious act occurred applies. When both parties have the same nationality, or have their domicile in the same country, their national law or the law of their domicile may also be applied.

Where acts occur abroad that are not considered tortious acts by the law of the People's Republic of China when they occur in China, they are not to be treated as tortious acts.

Article 147. In regard to the marriage of a citizen of the People's Republic of China with a foreigner, the law of the place where the marriage is entered into applies; for divorce, the law of the forum hearing the case applies.

Article 148. In regard to support, the law of the country which has the closest connection with the supported person applies.

Article 149. In regard to succession determined by inheritance law, the law of the deceased's domicile at the time of death applies to movable property; for immovable property, the law of the place where the immovable property is located applies.

Article 150. Where foreign law or international custom is applied in accordance with this chapter, there must not be a violation of the public interest of the People's Republic of China.

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Appendix IV

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