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Feng Chen

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THE NEW ERA OF CHINESE CONTRACT LAW: HISTORY, DEVELOPMENT AND A COMPARATIVE ANALYSIS

*Feng Chen**

I. INTRODUCTION

As China strengthened her effort to knock on the door of the World Trade Organization ("WTO"), she enacted a new uniform contract law in order to pursue this goal. This article describes the history of China's contract law system in the past twenty years and introduces these important changes. The article also contrasts the new Contract Law of China ("CLC") with the United States' Uniform Commercial Code ("U.C.C.") and the United Nation's Convention on Contracts for the International Sale of Goods ("CISG"). Through comparison, one can recognize about the great achievements China has made in her contract law system in the past two decades. While her cultural history dates back thousands of years, China's legal history is much shorter than most of the West. In order to

* Lecturer of Law, Sichuan University School of Law, People's Republic of China; Master of Law, Southwest Political Science and Law University, People's Republic of China; LL.M., Tulane University School of Law.

keep pace with international standards, China has absorbed many matured legal doctrines from both civil and Anglo-American legal systems.

In 1986, China began her effort to join the General Agreement on Tariffs and Trade ("GATT") (now known as the WTO). Though China was one of the contracting countries of the GATT, she interrupted her relations with GATT when the Communist Party took power in 1949.¹ China, isolated from the Western world, only retained her trade relations with socialist regimes. China's social and legal infrastructure is also largely unfamiliar to Western countries. In order to meet the requirements of the WTO today, China has taken a series of measures to change her social, economic, and legal systems.

Prior to 1999, China had enacted several contract laws dealing with different trade domains.² To a great extent, these laws reflected the need for a centralized planned economy. At least three contract law systems existed, each containing a number of different requirements.³ For the purpose of creating a uniform market economy and entering the WTO, there was a strong need to change this chaotic state of contract law. Therefore, the highest legislative body in China, the National People's Congress of the People's Republic of China ("NPC") enacted the CLC on March 15, 1999, which became effective on October 1, 1999. The CLC differs significantly from former contract laws of China and attempts to bring a once chaotic contract legal system to an end.

Part II of this Article will first review the history and development of contract law in China since 1978 and

1. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 [hereinafter GATT]. In late 1988, the Chinese delegation indicated that China originally assumed contracting party status by accepting the Protocol of Provisional Application, dated October 30, 1947. The deposed Chiang-Kai Shek regime ceased to represent China as from October 1, 1949. The Chinese government argues that the founding of the People's Republic of China in 1949 did not alter China's status as a subject of international law. Therefore, the withdrawal from GATT in the name of China by the authority in Taiwan in 1950 was not legally valid. See WANG YI, *GATT & WTO: LAW AND RULES FOR WORLD TRADE* 169-70 (1998).

2. WEI LUO, *THE CONTRACT LAW OF THE PEOPLE'S REPUBLIC OF CHINA: WITH ENGLISH TRANSLATION AND INTRODUCTION* 1 (1999).

3. *Id.* at 1-8.

give a short description of the structure of China's former contract laws. Part III will briefly introduce the general setting of the CLC, and in greater detail compare the CLC's provisions concerning sales contracts to the CISG and the U.C.C.

II. DEVELOPMENT OF CONTRACT LAW IN THE PEOPLE'S REPUBLIC OF CHINA

After the death of Chairman Mao ZeDong in 1976, the subsequent leaders successfully cracked down on the "Gang of Four" counterrevolutionary group, the political cabal led by the widow of Chairman Mao.⁴ The new leaders began to rethink the suffering and pain that arose from the Cultural Revolution and started to advocate social and economic reform and an "open door" policy towards other nations. In 1978, the Third Session of the Eleventh Congress of the Communist Party brought to power reform-minded officials led by Deng XiaoPing.⁵ Deng, who became the paramount leader of that time, led a movement within the highest reaches of the Communist Party that, while not forsaking centralized planning, re-oriented both the Communist Party and the People's Republic of China ("P.R.C.") towards a significantly more decentralized, market-oriented, and incentive-based economy that was much more open to international trade.⁶ The basic objective was to realize "Four Modernizations" in China.⁷ The inherent meaning of this slogan was to realize the modernization of industry, agriculture, science, and military defense.⁸ In order to achieve this goal, it became necessary to reform the past economic regime.

4. See generally DAVID BONAVIA, *VERDICT IN PEKING: THE TRIAL OF THE GANG OF FOUR* (1984).

5. Zhong Jianhua & Yu Guanghua, *China's Uniform Contract Law: Progress and Problems*, 17 UCLA PAC. BASIN L.J. 1, 4 (1999).

6. See Lester Ross, *Force Majeure and Related Doctrines of Excuse in Contract Law of the People's Republic of China*, 5 J. CHINESE L. 58, 59 (1991).

7. See Zhou Enlai, *Government Working Report at the Third National People's Congress Meeting 1964*, 18 STATE DEPARTMENT GAZETTE OF THE PEOPLE'S REPUBLIC OF CHINA 344 (1964), available at <http://www.peopledaily.com.cn/item/lianghui/zhb/rd/3jie/newfiles/a1030.html> (last visited Oct. 31, 2001).

8. See *id.*

Before 1978, the centrally planned economy was so prevailing that the government controlled nearly all commodity flows.⁹ Observing Chinese history, it is interesting to note that the country never experienced a capitalist stage. A market economy failed to dominate during the period between the collapse of the Qing dynasty in 1911 and the birth of the P.R.C. in 1949.¹⁰ While it is true that the former Soviet model of a centralized planned economy directly influences the economic system in China, it cannot be understood as a copy of the Soviet's model.¹¹ Due to China's own unique characteristics, the first step of the post-1978 reform dealt primarily with agricultural economic reform. This effort proved to be a great success. The peasants were encouraged to enter into agricultural contracts with the agricultural collective organization. Those peasants then could use the communal land for the purpose of growing crops and make their own profits. This greatly changed the old policy that required equal pay for all farmers. The second step was urban economic reform, which mainly focused on state-run industry.¹² Unlike agricultural economic reform, however, urban economic reform proved to be a great task. Since the Cultural Revolution had nearly destroyed the entire Chinese legal system, urban economic reform proved to be a much more complicated issue than the earlier agricultural changes. To accomplish the urban economic reform, it became necessary to enact a comprehensive legal structure.

In order to maintain the giant "vessel" (here, vessel means China), the NPC began to enact a series of laws. Since 1978, five laws and more than ten regulations have been enacted to govern contracts in China, and the distinguishing feature of these contract laws was their diversity.¹³ The General Principles of the Civil Law ("GPCL") stipulated the basic principles of contract, while the Economic Contract Law ("ECL"), the Foreign Economic Contract Law ("FECL") and the Technology Contract Law

9. Zhong & Yu, *supra* note 5, at 3.

10. *See id.* at 2-11.

11. *See* Wang Liming & Xu Chuanxi, *Fundamental Principles of China's Contract Law*, 13 COLUM. J. ASIAN L. 1 (1999).

12. Zhong & Yu, *supra* note 5, at 4.

13. *Id.*

("TCL") set forth the substantive standards for specific types of contracts and their scope.¹⁴ Finally, the CISG was ratified and adopted to govern international contracts for the sale of goods between parties in China and those from other signatory nations.¹⁵

Among these laws, the ECL was the first to be enacted on December 13, 1981, and took effect on July 1, 1982, the sixty-first birthday of the China Communist Party.¹⁶ In order to implement the ECL, the State Council and other authorized administrative bureaus also enacted a series of contract regulations in the following years.¹⁷ These regulations dealt widely with the purchase and sale of industrial and mineral products, agricultural products, loan agreements, property insurance contracts, transportation contracts and storage contracts. In 1985, the NPC enacted the FECL and, in 1986, followed with the GPCL.¹⁸ In 1987, the Standing Committee of the NPC enacted the TCL. Further, China ratified the CISG in 1988.¹⁹

A. The General Principles of the Civil Law

The function of the GPCL is similar to that of a civil code, though its provisions are somewhat abstract. The GPCL regulates the basic principles governing civil and commercial transactions.²⁰ Specifically, Article 85 of the GPCL sets forth the definition of a contract, in that a "contract" is an agreement used for establishing, changing

14. See Ping Jiang, *Drafting the Uniform Contract Law in China*, 10 COLUM. J. ASIAN L. 245, 246 (1996).

15. United Nations Convention on Contracts for the International Sale of Goods, Apr. 10, 1980, U.N. Doc. A/CONF.97/18, art. 15, 19 I.L.M. 668 (1980) [hereinafter CISG].

16. See ZHONGHUA RENMIN GONGHEGUO JINGJI HETONG FA (Economic Contract Law of the People's Republic of China) art. 57 (1983), *translated in* 22 I.L.M. 330 (1983) [hereinafter ECL 1983].

17. Zhong & Yu, *supra* note 5, at 4.

18. *Id.*

19. See *id.* at n.27.

20. ZHONGHUA RENMIN GONGHEGUO MINFA TONGZE (General Principles of the Civil Law of the People's Republic of China) arts. 1, 2, 4, 85, *translated in* LEGISLATIVE AFFAIRS COMM'N OF THE STANDING COMM. OF THE NAT'L PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA, THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA 1983-1986 225-49 (1987) [hereinafter GPCL].

or terminating a civil relationship between parties.²¹ The GPCL also deals with contract performance issues, liability for breach of contract, and provides some contractual gap filler provisions.²² These mainly deal with issues such as price, quality, and other standard terms if there is no such agreement in the contract.

The distinguishing feature of the GPCL is that it defines the meaning and requirements of a legal person.²³ Any type of enterprise can be a legal person if they meet the conditions set by law. Traditionally, Chinese state-run enterprises were thought of as branches of government.²⁴ The legal person system was beneficial in that for the first time it established a separation between government and state-run enterprise. A legal person has its own independent civil rights, including the right to enter into contracts, and assume civil liability independently within its own capacity.²⁵ By setting up such a system, state-run enterprises were able to gain independent status rather than act as an affiliate of a government branch.

B. The Economic Contract Law

In 1981, the NPC enacted the ECL as the first contract law in the P.R.C. It was enacted four years prior to the GPCL, and in effect set in motion the free-market wave in China.

In China, scholars often classify contracts into nominated contracts and contracts without title. Contracts that have peculiar names are called nominated contracts. Article 8 of the ECL provided that contracts for purchase and sale, construction projects, processing and assembling, goods and transportation, electricity, storage, loans, property leases, property insurance and other eco-

21. *Id.* art. 85.

22. *Id.* art. 88.

23. *Id.* ch. III. Specifically, Article 36 provides that a legal person shall be an organization with the capacity for civil rights and civil conduct, and can independently enjoy these rights and obligations in accordance with the law. *Id.* art. 36.

24. Zhong & Yu, *supra* note 5, at 3.

25. GPCL art. 36.

conomic contracts were to be governed by this law.²⁶ The term "other economic contract" meant contracts without peculiar classification.²⁷ After the enactment of the ECL, the State Council enacted a series of detailed regulations on the listed nominated contracts to supplement the ECL. Studying those regulations, one could find strong central-planning characteristics. Some regulations seriously impeded freedom of contract.

In China, the origin of "economic contract" is derived from the former Soviet Union. Chinese scholars paid much attention to the Soviet legal system as the two countries' social and economic structure had certain similarities at the time. Scholars thought that it was improper to use a Western contract system to adjust the relationship of the socialist state-run factories. Thus, they put forward the notion of the economic contract. Article 2 of the ECL provided that an economic contract is an agreement between legal persons to fulfill certain economic goals and to determine the rights and obligations of both sides.²⁸

The scope of the ECL was very narrow as it only applied to legal persons,²⁹ such as firms, companies or corporations. The natural person was not included within this definition. In 1993, the NPC revised the ECL and enlarged its scope of application.³⁰ As amended, the ECL applied to the contracts entered into by legal persons, other economic organizations, individual business households (*getihu*) and farmers who signed an agricultural responsibility contract (*nongchunchengbao jinnyunhu*).³¹ But, again, a natural person who was not a merchant still lacked the capacity to enter into a contract.

These 1993 changes make it strongly evident that when the ECL was first enacted in 1981, it was solely intended for regulating contractual relationships among

26. ECL 1983 art. 8.

27. *Id.*

28. *Id.* art. 2.

29. *Id.*

30. Wang & Xu, *supra* note 11, at 5.

31. ZHONGHUA RENMIN GONGHEGUO JINGJI HETONG FA (Economic Contract Law of the People's Republic of China) art. 2 (1993), translated in LEGISLATIVE AFFAIRS COMM'N OF THE STANDING COMM. OF THE NAT'L PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA, THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA 167-91 (1995) [hereinafter ECL 1993].

state-run enterprises, collective-run enterprises and joint-venture enterprises. Because most subjects of the ECL were Chinese domestic legal persons, the features of state planning, therefore, were still reflected. For instance, Article 11 provided that an enterprise, which received the planned mandatory order from the state, shall enter into a contract in accordance with the rights and obligations of relevant law and administrative regulation.³² Article 13 also provided that contracting parties were required to use Chinese currency to pay all debt.³³

But it is important to remember that at the time of the ECL, the government wanted to move away from the traditional method of controlling enterprise by simply giving an administrative planned-order.³⁴ Managing enterprise by means of legal device was now their goal. The underlying intent of the ECL was to promote urban economic reform that focused on liberalizing state-run enterprise from the constraints of government branches.³⁵ The reform-minded leaders realized that it was more rational to allow state-run enterprise to become "relatively independent socialist commodity manufacturers and dealers with full authority for their own management and full responsibility for their own profits and losses."³⁶ The ECL was thus enacted to meet the requirements of this policy.

The ECL contained some of the basic doctrines and principles enshrined in Western civil and common contract law, such as good faith and mutual assent.³⁷ However, unlike some Western approaches, the ECL heavily stressed the written requirement in order to prevent fraud and bad faith.³⁸ It required that all transactions be evidenced by a writing, except for face-to-face contracts

32. *Id.* art. 11.

33. *Id.* art. 13.

34. Zhong & Yu, *supra* note 5, at 4.

35. See ECL 1993 art. 1.

36. Zhaong Yuqing & James S. McLean, *China's Foreign Economic Contract Law: Its Significance and Analysis*, BEIJING REV., Apr. 28, 1986, at 16-17, reprinted in 8 NW. J. INT'L L. & BUS. 120, 124 (1987) (quoting the seventh Five-Year Plan of the People's Republic of China for Economic and Social Development).

37. ECL 1993 art. 5.

38. Zhong & Yu, *supra* note 5, at 10.

that were to be completed at once.³⁹ The parties were to conform to the principles of equity and mutual benefit during the process of making a contract. One party could not forcefully impose an idea on the other. Rather, parties were to arrive at mutual assent through equal negotiation.⁴⁰ No unit or individual could unlawfully intervene.⁴¹ Therefore, the ECL gave contracting parties the right to make their own choices in forming a contract, and restricted the government from randomly intervening in the contract making process.

Although all Chinese law school contract courses pay great attention to offer and acceptance, the GPCL, ECL, FECL and TCL failed to even mention the terms. Similar to the U.C.C., the ECL stressed agreement, which came into being through bargain.⁴² Under the ECL, there was no need to analyze contract formation in terms of a formal offer and acceptance. As with the U.C.C., it was sufficient that the parties reached agreement or acted in a manner suggesting agreement.⁴³ Whether particular terms were necessary under the ECL to establish an agreement was a source of difference of opinion. The dispute arose from ECL Article 12, which provided that an economic contract shall consist of the following main terms: 1) subject matter of contract (goods, labor, project, etc.); 2) quantity and quality; 3) price or commission; 4) time, place, and manner of performance; and 5) liability for breach of contract. The contract shall also include clauses stipulated by law or those considered indispensable by either party.⁴⁴ Whether Article 12 was a mandatory provision or a permissive one became the focus. The key point, which gave rise to different understandings, was how to interpret the meaning of the Chinese word *ying*, which translates into "shall" in the provision above. *Ying* can also be construed as having a mandatory meaning in

39. ECL 1993 art. 3.

40. *Id.* art. 5.

41. *Id.*

42. *See id.* art. 9.

43. *See* CLAYTON P. GILLETTE & STEVEN D. WALT, SALES LAW 46 (1999). *See also* U.C.C. § 2-204(1) (2001) ("A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.").

44. ECL 1993 art. 12.

Chinese criminal law.⁴⁵ But *ying* can also mean that parties can have a free selection within the scope of the law.

Some courts nonetheless decided that a contract was void if any of the requirements set by Article 12 were not met.⁴⁶ This approach was unsatisfactory in the author's view. If this Article were construed as mandatory, a great number of contracts would have been rendered void, even though both parties had the intent to fulfill their obligations. The principle of freedom of contract should also be taken into account in interpreting Article 12. In fact, both the GPCL and ECL contained many gap filler provisions.⁴⁷ Such a mandatory understanding of Article 12 would make those gap filler provisions meaningless. Thus, except for quantity terms, all other terms listed in Article 12 should have been considered elective.

C. The Foreign Economic Contract Law

The FECL, enacted in 1985, applied to contracts between Chinese enterprises (or other economic organizations), foreign enterprises and individuals, except for international transportation contracts.⁴⁸ Chinese individuals were expressly excluded.⁴⁹

There were no provisions in the FECL that defined the term "contract." It has been argued that the ECL's definition of "contract" could be applicable to the FECL.⁵⁰ However, in the author's view these arguments are

45. See ZHONGHUA RENMIN GONGHEGUO XINFÄ (Criminal Law of the People's Republic of China) art. 395, *translated in* LEGISLATIVE AFFAIRS COMM'N OF THE STANDING COMM. OF THE NAT'L PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA, THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA 1997 21-149 (1998).

46. Unfortunately, Chinese lower courts seldom publish cases and rulings, and only the highest courts will infrequently publish some cases. Scholars and lawyers come to these conclusions from academic meetings with judges or through the practice of law.

47. ECL 1993 art. 17.

48. ZHONGHUA RENMIN GONGHEGUO SHEWAI JINGJI HETONG FA (Foreign Economic Contract Law of the People's Republic of China) art. 2 (1985), *translated in* 24 I.L.M. 797 (1985) [hereinafter FECL].

49. See generally *id.*

50. Gary J. Dernelle, *Direct Foreign Investment and Contractual Relations in the People's Republic of China*, 6 DEPAUL BUS. L.J. 331, 349 (1994).

flawed. The ECL only defined "economic contract,"⁵¹ which applied to legal persons while excluding natural persons. It would be inappropriate to use economic contract terms under the ECL to interpret FECL contracts. The ECL was exclusively for domestic trade between Chinese legal persons, and the FECL was for international trade. The GPCL is the only proper source that provides the definition of contract. This is a preferable interpretation, particularly because the GPCL has the function of civil law code. Assuming that the GPCL definition of "contract" applied to the FECL, a contract under the FECL would mean an agreement for establishing, changing or terminating the rights and obligations of each party.⁵²

Chapter I of the FECL contained general provisions and was comprised of six articles.⁵³ The scope of the FECL was so broad that almost all commercial activities with foreign entities were within its reach. The FECL could apply to sales, equity joint ventures, contractual joint ventures, contracts for joint exploration and development of natural resources, loans, leases, technology transfer, project contracts, processing and assembling agreements, labor, compensation, trade, scientific consulting and design, guarantees, insurance, bailment and agency.⁵⁴ Under the FECL, each party had equal legal status, which is to say that all parties were equally protected by law, with no super-power conferred to the larger or more powerful one.⁵⁵ Also, contracts were to be made in accordance with Chinese law and could not infringe on social public interests.⁵⁶ Parties to the agreement were required to abide by principles of fair dealing and mutual benefit at the time of contracting.⁵⁷ This clause gave a judge the authority to prevent an unconscionable contract. Both parties were to get what they wanted through the contract, a principle somewhat difficult for Westerners to understand, as this clause was not comparable to the expectation interest in

51. ECL 1993 art. 1.

52. GPCL art. 85.

53. *See generally* FECL ch. I.

54. *See* Interpretation of the Foreign Economic Contract Law, Zui-gao Renmin Fayuan Gongbao, Oct. 19, 1987, Part I, art. 1 (Supreme People's Court) [hereinafter Interpretation of the FECL].

55. FECL art. 3.

56. *See id.* art. 4.

57. *See id.* art. 3.

American contract law. Rather, "mutual benefit" as it was stated, meant both parties shall make their own profit by entering into contract.

Article 5 of the FECL contained a choice of law provision that addressed the ability of parties to select the applicable law to govern a dispute.⁵⁸ The right of selection was conferred upon both parties. Absent a choice of law term or an inability of the parties to reach an agreement on the issue, the judge was to apply the law with the closest connection to contract.⁵⁹ Contract disputes included those concerning the validity of a contract, the time of a valid contract, the interpretation of contract terms, contract performance, liability for breach and modification, termination, assignment and cancellation. Under normal situations, the choice of law for international sales contracts was to be the law of the seller's place of business. But if a contract was either negotiated and entered into in the buyer's place of business, or the main contract terms were followed by buyer's bid, or the contract explicitly provided that the seller must deliver the goods at the buyer's place of business, then the judge was to apply the law of the buyer's place of business.⁶⁰

As did the ECL, the FECL placed great emphasis on writing,⁶¹ allowing parties to make a deal through an exchange of mail, telegram, or facsimile.⁶² Oral agreements were unenforceable. If, however, one party required an affirmative letter, then a contract could be made only after both parties signed the letter.⁶³ Further, some contracts required approval from the government.⁶⁴ Fearing capitalist exploitation, China had earlier cut off her trade relationship with the Western world for more than two decades, thus, it is understandable that the FECL required a written form as evidence of contract.

Unlike the ECL, however, the FECL gave more freedom to the contracting parties. Article 12 of the FECL

58. *Id.* art. 5.

59. *Id.*

60. *See* Interpretation of the FECL, *supra* note 54, Part 2, art. 6(1).

61. *See* FECL ch. II.

62. *See id.* art. 7.

63. *Id.*

64. *Id.*

provided that a foreign economic contract generally could contain the following main terms:

1) the corporate or personal name, nationalities and principal places of business of each party; 2) the date and place of the contract's signature; 3) the type of contract and specification of the contract subject; 4) the quality standard and quantity of the contract's subject; 5) time, place and mode of performance; 6) price term, or payment amount; 7) the conditions for assignment of the contract; 8) liability for breach of contract; 9) dispute settlement clause; and 10) the language used to write the contract and its legal effect.⁶⁵

While the freedom to contract was one of the goals of the FECL, parties could, by agreement, displace most items of this Article.⁶⁶ As far as contract performance, modification, assignment and remedies were concerned, the FECL also gave more freedom to the parties themselves and absorbed some Western legal conceptions such as *force majeure* and the right to adequate assurance of performance. Article 17 of the FECL stated that "[w]hen a party has accurate evidence that the other party cannot execute the contract, he may temporarily suspend performance and immediately notify the other party. He shall execute the contract if the other party provides adequate assurance. A party who suspends performance assumes liability for breach if he does not have accurate evidence concerning the other's inability to perform under the contract."⁶⁷ When compared to U.C.C. § 2-609, the FECL's requirement was stricter. Under the U.C.C., when reasonable grounds for insecurity exist, the insecure party has the ability to take protective legal measures. The standard test for reasonable grounds is a commercial standard under the U.C.C., not a legal one.⁶⁸ By contrast, the FECL required accurate evidence that the other party really could not perform in the future. Therefore, mere suspicion, rumor or hearsay evidence could not sustain a demand for adequate assurances under the FECL.

There was one important difference between the ECL and FECL, on the issue of liquidated damages.⁶⁹ The

65. See *id.* art. 12.

66. *Id.* art. 28.

67. FECL art. 17.

68. U.C.C. § 2-609(2) (2001).

69. Compare ECL 1993 art. 35 with FECL art. 20.

ECL was tough on damages, a position that illustrated its reflection of a state-planned economy. The nature of liquidated damages in the ECL included both compensatory and punitive functions. The FECL, on the other hand, disagreed with the ECL's negative perspective by emphasizing the compensatory function of liquidated damages clauses.⁷⁰ The parties therefore could agree to the amount of liquidated damages under the FECL. A U.S. scholar has argued, erroneously, that the liquidated damages provision in the FECL was a penalty payment.⁷¹ However, if liquidated damages were much higher than the actual loss, parties could ask a court or arbitration agency to reduce the award.⁷² This strongly suggests that the FECL's liquidated damages clauses were to be viewed as damage compensation for breach of contract, rather than as punitive in function.

D. The Technology Contract Law

The TCL, which consisted of seven chapters and fifty-five provisions, was enacted by the NPC in 1987 and later implemented in 1989. The law gave Chinese legal persons and individuals the capacity to enter into technology contracts, however, the TCL did not apply to agreements involving a foreign party.⁷³ While both the ECL and FECL excluded an individual's capacity to contract, the TCL did not have such a limitation.⁷⁴ The TCL classified a technology contract into four categories and provided definitions for each of these categories: 1) technology development contracts; 2) technology transfer contracts; 3) technology consultant contracts; and 4) technol-

70. Under the ECL 1993, the breached party should pay liquidated damages regardless of loss suffered by the aggrieved party. *See* ECL 1993 ch. IV.

71. *See* Dernelle, *supra* note 50, at 357.

72. *See* FECL arts. 20, 37-38.

73. ZHONGHUA RENMIN GONGHEGUO JISHU HETONG FA (Technology Contract Law of the People's Republic of China) art. 2 (1987), *translated in* LEGISLATIVE AFFAIRS COMM'N OF THE STANDING COMM. OF THE NAT'L PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA, *THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA 1987-1989* 25-39 (1990) [hereinafter TCL].

74. *Id.*

ogy service contracts.⁷⁵ Patent, hardware and software design were all within its application.

One of the important issues that the TCL intended to clarify was the ownership of new technology invented by an employee of a state-run enterprise. Prior to 1987, many leaders and officials of state-run enterprises insisted that all new technology invented by their employees must belong to the state, or more directly, to the specific enterprise that provided a job position for the inventor.⁷⁶ This policy perspective led to a number of disputes.⁷⁷ One strong point of view argued that a commodity economy should respect the value of knowledge. The TCL, thus, made it clear that if an employee of a state-run enterprise invented a new technology without any connection to the job position or without utilizing the enterprise's facilities, the title of this new technology should belong to the employee.⁷⁸ This provision reflects the emphasis of individual rights in the FECL, and comparatively speaking, the TCL provided more freedom than the ECL. For instance, the TCL did not limit parties to the use of Chinese currency as the sole means of payment, and allowed parties to decide the contract terms by themselves.

E. Summary

The legal provisions discussed in these sections demonstrate that since 1978, China has made great strides in framing a legal system conducive to the development of a market economy. This network recognized China's socialist traditions and reflected the real social condition as well. The ECL, FECL and TCL dealt with domestic, international and technological trade aspects, respectively. They pointed to different legal aspects and reflected the true social structure of China. With the further development of the economy and in-depth economic reform, however, the drawbacks of these three laws became more evident. As previously suggested, their formal-

75. See generally TCL chs. III-V.

76. Yuan Cheng, *Legal Protection of Trade Secrets in the People's Republic of China*, 5 PAC. RIM L. & POL'Y J. 261, 264 (1996).

77. *Id.* at 265.

78. TCL art. 6.

ity and content had some ambiguous, repetitive and sometimes contradictory elements. Moreover, the scope of their application remained relatively limited. It is from this history that the new CLC emerged.

III. THE CONTRACT LAW OF CHINA

In China, there is a strong appeal for a uniform contract law in order to avoid confusion and uncertainty. When examining the contract law systems of the world, it is clear that uniformity is the inherent requirement arising out of a market economy.⁷⁹ Thus, the creation of uniformity throughout China was one of the main objectives of the CLC, which took effect on October 1, 1999, the National Day of the P.R.C.⁸⁰ The ECL, FECL and TCL were revoked at the same time. Uniform law is beneficial in resolving disparate understandings that have arisen due to differences in previous laws. Contract law that is applicable to all areas will better serve the homogeneous market prescribed by the policy.⁸¹ Moreover, uniformity can also create efficiency, the ultimate goal for a market economy. Besides this goal, modernization and scientific innovation are further desired effects of the CLC.⁸²

This section will discuss the most important provisions of the CLC. Specific attention will be given to the manner in which the CLC resolves some of the issues that arose from the ECL, FECL and TCL. This section will also draw out some of the similarities and differences between the CLC, CISG and U.C.C.

A. General Principles and Scope

There are twenty-three chapters and 428 provisions in the CLC, classified into two parts. The structure of the

79. See Liming Wang, *Foreword: China's Proposed Uniform Contract Law*, 31 ST. MARY'S L.J. 7, 11 (1999).

80. See LUO, *supra* note 2, at 10.

81. See *Special Report on Uniform Contract Law*, PEOPLE'S DAILY, Mar. 26, 1999, at <http://202.099.23.245/haiwai/199903/26/newfiles/F103.html> (last visited Oct. 31, 2001) (on file with *Journal*).

82. *Id.*

CLC differs greatly from the former contract laws discussed previously. The first part includes eight chapters that mainly deal with principles, formation, performance, modification, transfer, termination and liability for breach of contract.⁸³ This part of the CLC consists of general principles, which apply to any kind of specific contract. The second part includes the following fifteen chapters that list various nominated contracts: 1) sale; 2) contracts for providing electricity, water, gas, and heat; 3) donation; 4) loan; 5) lease; 6) contracts for financial leases; 7) contracts for work; 8) contracts for construction projects; 9) contracts for transportation; 10) contracts for technology; 11) contracts for storage; 12) contracts for warehouse; 13) contracts for commission; 14) brokerage contracts; and 15) contracts for intermediation.⁸⁴ Most significantly, the CLC abolished the term "economic contract" that contained a strong characteristic of a centrally planned economy.⁸⁵ To meet the need of China's social reality today, the CLC places the principle of freedom of contract as its priority.

There are eight provisions in Chapter I.⁸⁶ The general principles of the CLC are freedom of contract, equal legal status between parties, good faith, fairness, respect for society, morality and obedience of law and regulation.⁸⁷ No social entity or individual may illegally interfere with the contractual rights of parties.⁸⁸ Article 2 of the CLC provides that a contract is the agreement made between individuals, legal persons, and other organizations for the purpose of establishing, modifying, or terminating civil rights and obligations.⁸⁹ Thus, the CLC actually abolishes previous limitations concerning the scope of contracts. For example, under the FECL, a Chinese individual was unable to enter into a contract with a foreign company

83. See ZHONGHUA RENMIN GONGHEGUO HETONG FA (Contract Law of the People's Republic of China) arts. 1-129, *translated in* LEGISLATIVE AFFAIRS COMM'N OF THE STANDING COMM. OF THE NAT'L PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA, *THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA* 1999 9-76 (2000) [hereinafter CLC].

84. See CLC arts. 130-427.

85. See *Special Report on Uniform Contract Law*, *supra* note 81.

86. See generally CLC arts. 1-8.

87. *Id.*

88. See *id.* art. 4.

89. *Id.* art. 2.

unless that individual set up a company within China.⁹⁰ The ECL also limited an individual's capacity to conclude economic contracts.⁹¹ In fact, those limitations set by former contract law arguably violated the Chinese constitution, which provides that a Chinese citizen shall have the right and obligation to work.⁹²

B. Contract Formation

1. Basic Principles Governing Formation

The CLC implements several significant changes in contract formation rules. For example, a contract can now be made in any manner.⁹³ Unlike former contract laws that adhered to the written requirement, such as the FECL and ECL, the CLC allows agreements to be reached orally or by any other mode. Under the CLC, writings include forms that can show the described contents visibly, such as a written contractual agreement, letters and data-telex.⁹⁴

In order to avoid disputes over the basic and necessary terms of a contract, the Chinese word *ying* in the ECL has been deleted in the CLC. The CLC provides that parties should decide the content of a contract but recommends some basic terms as reference. Article 12 states that contracts normally include the following terms: 1) appellation or name of parties and their residence; 2) subject matter; 3) quantity; 4) quality; 5) price; 6) time limit, place and method of performance; 7) liability for breach of contract; and 8) methods of dispute resolution.⁹⁵ It seems that the CLC has made a complete change on the issue of mandatory or necessary terms. Unlike the U.C.C., which

90. FECL art. 2.

91. See generally ECL 1993 ch. II.

92. See XIANFA (Constitution of the P.R.C.) arts. 1, 42 (1993).

93. CLC art. 10.

94. See *id.* art. 11 (including telegram, telex, fax, electronic data information, and electronic mail).

95. *Id.* art. 12.

requires a quantity term,⁹⁶ the CLC does not have any mandatory terms for a contract. Furthermore, the CLC has no requirement that a contract must be in writing if it exceeds a certain value.⁹⁷

Modernization is another goal the CLC pursues, and its contract formation rules reflect this. Parties are now capable of making a contract by means of electronic data.⁹⁸ If the offeree specifies the computer system to receive electronic data, the offer becomes effective at the time of logging into that specified system; if there is no specified computer system, the offer becomes effective at the time of logging into any computer system owned by the offeree.⁹⁹ There is no doubt that the CLC takes a positive attitude toward the modern development of electronic transmissions. It is interesting that the U.C.C. has yet to have such a validation of modern technology, even though electronic trade is very popular in the U.S.¹⁰⁰ By contrast, electronic trade is a new concept in China. While many still employ the traditional ways of doing business, with respect to contract formation, Chinese contract law is quite advanced in this respect.

In recent years, there has been a strong movement in China to limit the power of big manufacturers over ordinary consumers. The CLC acknowledges this view by requiring the party who provides a standard boiler-plate contract form to explain the terms in accordance with the principle of fairness, and to draw the other party's atten-

96. See U.C.C. § 2-201 (2001) (the only term which must appear is the quantity term which need not be stated accurately, although recovery is limited to the amount stated).

97. See U.C.C. § 2-201(1) (2001) (contract for \$500 or more not enforceable unless sufficient writing exists).

98. CLC art. 11.

99. See *id.* art. 16.

100. The author notes that the American Law Institute has drafted proposed amendments to the U.C.C. to include rules for electronic contracting. These proposed amendments are being reviewed by the American Law Institute and the National Conference of Commissioners on Uniform State Laws during 2001-2002, and approval is expected relatively soon. U.C.C. art. 2 (Proposed Amendments 2001). Also, in 2000, President Clinton signed the Electronic Signatures in Global and National Commerce Act ("E-Sign Act"), effective on October 1, 2000, giving electronic signatures the same legal standing as their paper-and-pen counterparts. See *generally* Electronic Signatures in Global and National Commerce Act, 15 U.S.C.A. § 7001 (West Supp. 2001).

tion to the exclusion or restriction of liability in reasonable ways.¹⁰¹ Though the CLC does not mention consumer protections at all, the underlying purpose of this provision is quite obvious. To some extent, this provision provides additional legal tools for preventing exploitation by a monopoly and demonstrates a modernization characteristic, particularly in China where anti-trust law is practically non-existent. If a dispute over the understanding of the standard terms arises, it is to be interpreted according to general understanding.¹⁰² Where there are two or more kinds of interpretation, an interpretation unfavorable to the party supplying the standard terms shall be preferred. Where the standard terms are inconsistent with non-standard terms, the latter shall be adopted.¹⁰³ In the author's view, this approach is a fair one, as state-run enterprises in China have more power, ability and influence than do private businesses or individuals. Therefore, it is rational to balance uneven bargaining power by restraining use of standard pre-formulated contracts.

2. Offer and Acceptance

The CLC also clearly states that parties may conclude their contract by way of offer and acceptance.¹⁰⁴ This is an important change. While retaining the traditional agreement method, offer and acceptance become an additional tool for contract formation. In China, parties have traditionally concluded a contract by signing an affirmation letter after several rounds of negotiation. Under such circumstances, the contract will be formed at the time when the letter is signed.¹⁰⁵

As a new method for contract formation, the meanings of offer and acceptance therefore are important under the CLC. Article 14 defines the meaning of offer as the manifestation of willingness to enter into a contract with another. The content of the offer should be specific and definite. Upon acceptance, an offeror is bound by the in-

101. CLC art. 39.

102. *Id.* art. 41.

103. *Id.*

104. *Id.* art. 13.

105. *Id.* art. 33.

tent indicated in the offer.¹⁰⁶ A price list, advertisement and announcement of auction or bids are not offers, but rather are invitations to make an offer.¹⁰⁷ An advertisement is an offer only if it meets the set requirements.¹⁰⁸

Articles 21-23 of the CLC govern when a response to an offer becomes an acceptance, and provide that a statement made by the offeree that indicates assent to an offer is an acceptance.¹⁰⁹ The acceptance should reach the offeror by way of notification unless the course of dealing or the terms of the offer indicate that other conduct may also amount to giving acceptance. An acceptance is normally effective under Article 26 of the CLC at the moment the indication of assent reaches the offeror.¹¹⁰

Some interesting comparisons can be made between these CLC provisions and Western contract law. Under the CLC, the common law "mail-box" rule does not apply.¹¹¹ An acceptance is effective at the time when the offeree indicates assent, and it should reach the offeror within the time fixed in the offer.¹¹² Application of this CLC provision raises some interesting questions. Suppose seller, *S*, dispatches an offer to buyer, *B*, on January 1, stating that "this offer is valid until the end of January." *B* does not send an acceptance letter until January 30, and *S* receives the letter on February 3. Has a contract been formed under the CLC? In order to solve this question, a judge should consider other circumstantial facts. If *S* and *B* both are located in the same area, and under normal conditions this letter could be delivered to *S* on time but failed due to some other reasons, the acceptance should be considered effective unless *S* informed *B* that the offer is considered to have lapsed. If a notification to *S* is not necessary, then the judge should decide in accordance with the course of dealing or with the offer's express requirements.¹¹³

Compared with the CISG, the offer and acceptance rules of the CLC are quite similar. Under the CLC, an of-

106. *Id.* art. 14.

107. CLC art. 15.

108. *Id.*

109. *Id.* arts. 21-23.

110. *Id.* art. 26.

111. *See id.* art. 23.

112. *Id.*

113. CLC art. 26.

fer becomes effective when it reaches the offeree.¹¹⁴ An offer may be withdrawn if the revocation reaches the offeree before or at the same time as the offer.¹¹⁵ These provisions are in accordance with that of the CISG, which provides that an offer is irrevocable if there is a time period set for acceptance or an indication that the offer is irrevocable. Article 16(2)(b) of the CISG states that if an offeree has reasonable grounds to believe the offer is irrevocable and undertakes proper preparation for the performance of the contract, the offer is irrevocable.¹¹⁶ In applying this provision, good faith is required. This is the same rule as that articulated in California Supreme Court Justice Roger Traynor's memorable opinion in *Drennan v. Star Paving Co.*,¹¹⁷ and later restated in Section 87 of the Restatement (Second) of Contracts: "An offer, which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance, and which does include such action or forbearance is binding as an option contract to the extent necessary to avoid injustice."¹¹⁸ The CLC has adopted the same rule, under Article 19(2), and provides that an offer shall not be revoked if the offeree has reasons to rely on the offer as irrevocable and has made preparation for performing the contract.¹¹⁹

3. Battle of the Forms

Often, in actual commercial practice, an offeree's reply will contain some variation in terms from those in the offer. The CLC follows the CISG's treatment of an offer-varying acceptance,¹²⁰ and slightly changes the mirror image rule. Article 30 of the CLC provides that the contents of an acceptance shall comply with those of the offer.¹²¹ To constitute an acceptance, a reply must contain

114. *Id.* art. 16.

115. *Id.* art. 17.

116. CISG art. 16(2)(b).

117. *Drennan v. Star Paving Co.*, 333 P.2d 757, 760 (Cal. 1958).

118. RESTATEMENT (SECOND) OF CONTRACTS § 87(2) (1981).

119. CLC art. 19.

120. *Id.* art. 30.

121. *Id.*

all the terms stated in the offer. If the offeree substantially modifies the contents of the offer, it shall constitute a new counteroffer. For example, a modification relating to the contract object, quality, quantity, price or remuneration, time or place or method of performance, liabilities for breach of contract and the settlement of disputes shall constitute a substantial modification of an offer.¹²²

Although the first sentence in Article 30 of the CLC stresses the mirror image rule, Article 31 modifies the rule by stating that if the acceptance does not substantially modify the contents of the offer, it shall be effective, and the contents of the contract shall be subject to those of the acceptance, except as rejected promptly by the offeror or indicated in the offer that an acceptance may not modify the offer at all.¹²³

However, the term "substantial modification" under Article 30 is so broad that almost everything could conceivably be contained within that definition. Moreover, the specific enumeration of terms that do constitute "substantial modifications" under Article 30 are non-exhaustive. Therefore, almost all offer-varying replies will not constitute acceptance but rejections and counteroffers under the CLC.

The approach of the CLC is the same as that of the CISG rule for acceptance. Article 19(2) of the CISG states that a "reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror, without undue delay, objects orally to the discrepancy or dispatches a notice to that effect."¹²⁴ This subsection only applies to replies that contain non-material alterations of the terms of the offer. Similarly, Article 19(3) lists various terms that are considered material alterations under the CISG.¹²⁵

The CLC approach, while consistent with the CISG, differs from the U.C.C. Section 2-207(1) of the U.C.C. displaces the mirror image rule by stating that "[a] definite and seasonable expression of acceptance" acts as an acceptance "even though it states terms additional to or dif-

122. *Id.*

123. *Id.* art. 31.

124. CISG art. 19(2).

125. *Id.* art. 19(3).

ferent from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.”¹²⁶ Section 2-207(2) provides that the offer-varying terms in an acceptance under § 2-207(1) constitute “proposals for addition to the contract.”¹²⁷ However, between merchants, the offer-varying terms do not become part of the contract if the terms “materially alter the contract.”¹²⁸ There is no direct standard of “materiality” in the U.C.C. itself. To interpret this term, a court, with great flexibility and discretion, can only rely on case law¹²⁹ and official commentary to the U.C.C.¹³⁰

The different approaches of the U.C.C. and CLC can lead to different results. For instance, arbitration clauses would clearly be considered substantial modifications under the CLC. Thus, if an offeree’s reply contains a different arbitration clause, it would be considered a counteroffer. But under the U.C.C., the answer to whether an arbitration clause would “materially alter” the contract is not definite under case law.¹³¹ Having complexity and diversity, there is a greater risk of judicial mistake when judges decide the issue of materiality. On the other hand, the CLC, with a clear standard, makes it more predictable and easier for parties to handle the dispute themselves. The shortcoming, however, is a greater reliance on a mirror image rule that does not necessarily reflect the real needs of commercial activity.

4. Contract Validity

If a contract is concluded in accordance with law, under the CLC it becomes valid at the time of establishment unless approval or registration procedure is re-

126. U.C.C. § 2-207(1) (2001).

127. *Id.* § 2-207(2).

128. *Id.* § (b).

129. E. ALLAN FARNSWORTH, *CONTRACTS* § 3.21 (3d ed. 1999) (case law on material alteration test).

130. U.C.C. § 2-207 cmts. 4-5 (2001).

131. *See, e.g.,* *Shulze & Burch Biscuit Co. v. Tree Top*, 831 F.2d 709 (7th Cir. 1987) (arbitration clause is material alteration); *Dorton v. Collins & Aikman*, 453 F.2d 1161 (6th Cir. 1972) (fact-specific approach to issue); *Marlene Indus. Corp. v. Carnac Textiles*, 380 N.E.2d 239 (N.Y. 1978) (material alteration).

quired.¹³² As in the case of a real estate contract, it becomes effective at the time of registration. According to CLC Article 52, there are five specific situations that can "void" a contract.¹³³ The first is fraud and coercion by one party that damages the interests of the State.¹³⁴ In the past, a contract was per se void if fraud or coercion was involved.¹³⁵ The CLC adds a limitation. Only when the interest of the State is harmed, is the contract then void.¹³⁶ Unlike U.S. law, fraud that is egregious will lead a contract to be voided.¹³⁷ Chinese law does not have a further classification of fraud. The second situation destroying contract validity is malicious collusion that harms the interest of the State, the collective or a third party.¹³⁸ The third type of voidable contract is one that has an illegitimate purpose that is concealed under the guise of legitimate acts,¹³⁹ such as gambling contracts, land sale contracts¹⁴⁰ and contracts for sale of ammunition which are illegal in China. The fourth kind of is one that harms the public good.¹⁴¹ The last type is one that violates the mandatory law and regulation.¹⁴²

CLC Article 54 emphasizes that if a contract is fulfilled by one party against the other party's true intentions through the uses of fraud, coercion or exploitation of an unfavorable position, the injured party shall have the right to request the court or arbitration institution to modify or revoke the contract. If one party knows that the other party is in a vulnerable position, he may not use this weakness to his own advantage. Such an act is prohibited according to Chinese social policy. However, under

132. CLC art. 44.

133. *Id.* art. 52.

134. *Id.*

135. ECL 1993 art. 7(2).

136. CLC arts. 52(1)-(2).

137. *Id.* art. 52(3).

138. *Id.* art. 52(2).

139. *Id.* art. 52(3).

140. In China, the title to land belongs to the state. Individuals can only obtain the "use" right (usufruct) of land. See ZHONGHUA RENMIN GONGHEGUO TUDI GUANLI FA (Land Administration Law of the People's Republic of China) arts. 2, 8, *translated in* LEGISLATIVE AFFAIRS COMM'N OF THE STANDING COMM. OF THE NAT'L PEOPLE'S CONGRESS OF THE PEOPLE'S REPUBLIC OF CHINA, THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA 1998 83-109 (1999).

141. CLC art. 52(4).

142. *Id.* art. 52(5).

the CLC, there are no direct guidelines or unified formulas provided to judges in determining the validity of a contract involving these issues.

C. Contract Performance

Chapter IV of the CLC deals with contract performance issues and covers a series of gap-filler clauses. The CLC retains some of the former ECL rules for the performance of a state-planned contract. Under the CLC, performance is classified into two situations: Ordered performance and simultaneous performance.¹⁴³

1. Suspension of Performance

In ordered performance, the first party who is to perform its obligation often worries about the other's trustworthiness. In situations where there is evidence that the other party is in financial trouble, lacks commercial credibility, or has transferred property to avoid debt, the question of whether the first party has the right to suspend performance arises. As discussed earlier, under the repealed ECL, the answer was "no."¹⁴⁴ Thus, the first party had to take a risk of being sued if he decided to suspend performance. The CLC, however, allows the first party to suspend performance if there is conclusive evidence that the other party is under any of the following circumstances: "1) business operations seriously deteriorating; 2) diverting properties and withdrawing capital to evade debts; 3) falling into business discredit; or 4) other situations showing inability or possible inability to meet liabilities."¹⁴⁵

2. Warranty and Quality Issues

The CLC provisions governing product quality are different from the U.C.C. warranties regarding quality of

143. See, e.g., *id.* art. 66.

144. FECL art. 17.

145. CLC art. 68.

goods. The warranties recognized by the U.C.C. are: The express warranty; the implied warranty of merchantability; the warranty of fitness for a particular purpose; and the warranty of title and against infringement.¹⁴⁶ The CISG provisions governing product quality essentially mimic the U.C.C. warranties.¹⁴⁷ An express warranty under the U.C.C. is an affirmation, promise or guarantee by the seller that the goods will have certain qualities. The most important of these is the provision contained in § 2-313(1)(a) that “[a]ny affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.”¹⁴⁸ The affirmation need not be a “warranty or guarantee.”¹⁴⁹ Any affirmation will suffice to create an express warranty, even when lacking explicit words of guaranty.¹⁵⁰ It is apparent that the “basis of the bargain” test is the important factor in determining whether an express warranty exists under the U.C.C.¹⁵¹

Though there is no mention of “express warranty” in the CLC, it does have some provisions similar to the U.C.C. Article 153 of the CLC states that the seller shall deliver the goods according to the agreed quality requirements. In cases where the seller provides the quality specifications concerning the object, the delivered goods shall satisfy the quality requirements in such specifications.¹⁵² In Article 168, the CLC further states that “parties to a sale transaction by sample shall seal up the sample and may make specifications of its quality.”¹⁵³ The goods delivered by the seller are to have the same quality as the sample and its specifications. The only important difference between the CLC and U.C.C. is that the latter emphasizes that “descriptions” or a “sample or model” should be “part of the basis of the bargain.”¹⁵⁴

146. U.C.C. §§ 2-312, 2-313, 2-314, 2-315 (2001).

147. CISG art. 36.

148. U.C.C. § 2-313(1)(a) (2001).

149. *Id.* § 2-313(2).

150. *Id.* § 2-313 cmt. 3.

151. “No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain.” *Id.*

152. CLC art. 153.

153. *Id.* art. 168.

154. *See* U.C.C. § 2-313(1) (2001).

The implied warranty of merchantability is an important provision in the U.C.C. However, the requirement stating that goods must be "merchantable" is somewhat vague.¹⁵⁵ U.C.C. § 2-314(2) lists six criteria that goods must meet in order to be merchantable. The easiest one to understand is given in § 2-314(2)(c), by which goods must be "fit for the ordinary purposes for which such goods are used."¹⁵⁶

It is arguable whether the CLC contains such a broad implied warranty provision as that found in the U.C.C. In the author's understanding, there are some provisions in the CLC that suggest the inclusion of implied warranties in contracts. CLC Article 169 states that "[i]f the buyer to a sale transaction by sample is unaware of the sample's hidden defects, even if the targeted matter delivered is identical with the sample, the quality of the targeted matter delivered by the seller shall still conform to the common standards for the same category of objects."¹⁵⁷ Furthermore, Article 62(1) states that if the quality terms of a contract are unclear, the State standards or trade standards apply; and if there are no State standards or trade standards, normal or specific standards in conformity with the purpose of the contract shall apply.¹⁵⁸ While these provisions are not as broad as the U.C.C.'s "fit for ordinary purposes" warranty, they do constitute implied terms regarding the quality of the goods.

Unlike the U.C.C. and CISG, there is no special provision in the CLC governing the warranty of fitness for a particular purpose.¹⁵⁹ But, in the author's view, Article 62(1)'s reference to "specific standards" may provide some assistance on this matter. "Specific standards" in conformity with "the purpose of the contract" are to be applied

155. The text of the U.C.C. sets a threshold as to what standards goods must meet to be "merchantable." U.C.C. § 2-314(2) (2001). Comment 6 from this section explains that the standards in the text are not exhaustive of "other possible attributes of merchantability." *Id.* § 2-314 cmt. 6.

156. *Id.* § 2-314(2)(c).

157. CLC art. 169.

158. *Id.* art. 62(1).

159. See U.C.C. § 2-315 (2001) (implied warranty of fitness for a particular purpose); CISG art. 35(2)(b) (requiring "conforming" goods to be fit for any particular purpose "expressly or impliedly known to the seller at the time of the conclusion of the contract").

in the contract. The purpose of any contract contains an ordinary and particular purpose for which the goods are to be used. The standard in Article 62(1) is not a normal but a specific one.¹⁶⁰ It is possible that the inherent meaning of “purpose of the contract” could be construed as including “particular purpose.”

Article 150 of the CLC is a provision dealing with warranty of title and against infringement. It provides that “[t]he seller shall, in respect of the goods delivered, assume the obligation to guarantee that no third party may claim any right to the buyer, except as otherwise stipulated by law.”¹⁶¹ Furthermore, Article 130 states that a contract requires the seller to transfer the title of goods to the buyer. It is clear that the goods shall be delivered free of any mortgage, pledge or other lien.¹⁶² These new provisions mirror U.C.C. § 2-312, which reads that “there is in a contract for sale a warranty by the seller that (1) the title conveyed shall be good, and its transfer rightful; and (2) the goods shall be delivered free from any security interest, or other lien, or encumbrance of which the buyer at the time of contracting has no knowledge.”¹⁶³

3. Risk of Loss

Transporting goods from seller to buyer today is a perilous journey in China, and even more dangerous when the goods must travel overseas. The NPC seeks to address these problems by adding risk of loss provisions in the CLC. The risk of loss provisions vary from the principles that existed under pre-U.C.C. law, in which risk of loss was closely linked to title.¹⁶⁴ As the Washington Court of Appeals in *Galbraith v. American Motorhome Corp.* noted regarding the U.C.C. approach, the rationale of the risk of loss rules is to place the risk of loss on the party most likely to insure the goods. The rules recognize that a merchant who is to make physical delivery at his own place of business continues to exercise dominion and control over

160. CLC art. 62(1).

161. *Id.* art. 150.

162. *Id.* art. 130.

163. U.C.C. § 2-312(1) (2001).

164. See GILLETTE & WALT, *supra* note 43, at 251.

the goods and can be expected to insure his interest in them until delivery.¹⁶⁵

The U.C.C. does not rely on the title of goods in deciding the transfer of risk, rather it adopts a contractual approach toward the shifting of risk of loss from seller to buyer.¹⁶⁶ In the case of goods to be shipped by carrier, risk of loss shifts either upon delivery to the carrier or tender to the buyer, depending upon the contract terms.¹⁶⁷

Article 142 of the CLC adopts a somewhat different approach when it stipulates that "[t]he risk of damage to or missing of a subject thing, shall be borne by the seller before delivery and by the buyer after the delivery, except as otherwise stipulated by law or agreed upon by the parties."¹⁶⁸ Here, delivery has the same meaning as the receipt in U.C.C. Article 2. Suppose seller *A* in Chengdu, Sichuan province, agrees to sell widgets to buyer *B* in Beijing. Both parties agree to the place of delivery in Beijing. The seller must still assume the risk even if an independent carrier is involved. But under U.C.C. § 2-509(1)(a), the risk of loss will transfer to the buyer when the seller duly tenders to an independent carrier.¹⁶⁹ According to the CLC, if the parties did not mention the place of delivery in the contract, and the judge cannot determine where the place of delivery is by using a gap filler, the risk of loss shifts to the buyer after the seller has delivered the goods to the first carrier.¹⁷⁰ Unlike the U.C.C., the CLC does not distinguish the merchant seller from the non-merchant seller. According to U.C.C. § 2-509(3), risk of loss passes to the buyer on receipt of the goods if the seller is a merchant.¹⁷¹ If the seller is not a merchant, then the risk passes to the buyer on tender of delivery.¹⁷² In China, under the CLC, the status of the seller will have no effect on the determination of transfer of risk.

Like the U.C.C. and CISG, the CLC also contains a

165. *Galbraith v. Am. Motorhome Corp.*, 545 P.2d 561, 563 (Wash. Ct. App. 1976).

166. U.C.C. § 2-509 cmt. 1 (2001).

167. *Id.* § 2-509(1)(a)-(b).

168. CLC art. 142.

169. *See* U.C.C. § 2-509(1)(a) (2001).

170. *See* CLC art. 145.

171. U.C.C. § 2-509(3) (2001).

172. *Id.*

provision concerning the passage of risk when goods are sold while they are in transit. Under CLC Article 144, risk passes to the buyer at the conclusion of the contract where goods are resold in transit, except as otherwise agreed upon by the parties.¹⁷³ There are some important differences, however, between the CISG and CLC. Article 68 of the CISG announces that “if circumstances indicate otherwise, risk passes retroactively to the buyer from the time the goods were first handed to a carrier who issued documents covering them.”¹⁷⁴ It also provides that the risk remains on the seller if, at the conclusion of the contract, the seller knew and failed to disclose information that the goods had been destroyed.¹⁷⁵ The CLC lacks a similar provision, thus, it may give room for dishonest or fraudulent sellers, whose risk has been transferred to the buyer immediately after the contract is formed. Similar to the U.C.C., the CLC risk of loss rules change if a breach exists.¹⁷⁶ Article 148 provides that:

Where it is unable to realize the purpose of a contract because the quality of the subject thing has not satisfied the agreed quality requirement, the buyer may refuse to accept the subject thing or rescind the contract. Where the buyer refuses to accept the subject thing or rescinds the contract, the seller shall bear the risk of damage or missing of the subject thing.¹⁷⁷

4. Other Performance Issues

Article 91(4) of the CLC, a newly added provision, states that the rights and obligations of contracts shall be terminated when the obligor has “deposited the targeted matter according to law.”¹⁷⁸ For example, assume that the obligee changed his business address and failed to inform the obligor. Article 91(4) provides that the obligor can put the contract objects to an agency for deposit, and his obligation is then finished.¹⁷⁹

Another important provision in the CLC is the

173. CLC art. 144.

174. CISG art. 68.

175. *Id.*

176. U.C.C. § 2-510 (2001) (effect of breach on risk of loss).

177. CLC art. 148.

178. *Id.* art. 91(4).

179. *See id.*

right of subrogation. If the obligor delays in exercising its due creditor's rights, thus damaging the interests of the obligee, the obligee may request the court for subrogation in its own name, except that the creditor's right exclusively belongs to the obligor.¹⁸⁰ This provision greatly enhances the creditor's legal methods for protecting his own interests and will lessen a great number of unnecessary conflicts or disputes. More importantly, the subrogation rights will do well in solving "triangular debts" or "debt claims." In China, the statute of limitation on subrogation is two years.¹⁸¹

In addition, the CLC has other substantial changes such as the right of revocation. If an obligor renounces its due creditor's right or transfers its property at an obviously unreasonable low price, and the transferee knows of this situation, thus damaging the interests of the obligee, the obligee may request the court to revoke the obligor's act.¹⁸² The time limit for exercising the right of revocation is one year, commencing from the day the obligee became aware or ought to have become aware of the causes of revocation.¹⁸³ If the right of revocation has not been exercised within five years from the day when the act of the obligor takes place, such right shall be extinguished.¹⁸⁴

D. Modification and Assignment

Under the CLC, a contract may be modified if the parties reach a consensus through consultation.¹⁸⁵ Often, disputes will arise over how the modified terms are to be understood. Thus, the CLC provides that if a modified term is unclear, then presumably there is no modification.¹⁸⁶ The rationale of this rule is to force parties to act seriously in negotiating contract terms.

Under the common law, it is generally recognized that the mutual assent of both parties is essential to any

180. CLC art. 73.

181. GPCL art. 135.

182. CLC art. 74.

183. *Id.* art. 75.

184. *Id.*

185. *Id.* art. 77.

186. *Id.* art. 78.

modification. Modifying agreements, being themselves contracts, must be supported by consideration. If the modified terms change the duties of only one party, leaving the duty on the other the same as under the original contract, such modifications are rendered unenforceable.¹⁸⁷ The requirement of consideration is abolished in the U.C.C., which simply provides that a modifying agreement "needs no consideration to be binding."¹⁸⁸ Good faith is the only test imposed by the U.C.C. The effective use of bad faith to escape performance of the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith.¹⁸⁹

With respect to assignments, under the usual circumstances, the obligee can assign the whole or a part of his contractual rights to any third party, however, the CLC establishes three limitations.¹⁹⁰ According to the nature of some contracts, assignment may not be allowed. For example, contracts with strong personal characteristics cannot be assigned unless the obligor agrees to the assignment.¹⁹¹ Moreover, parties can also limit the assignment by agreement. If an obligee assigns his right but fails to notify the obligor, the assignment is deemed ineffective against the obligor.¹⁹² Under the U.C.C., rights can be assigned unless the contract provides otherwise, or where the assignment would "materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance."¹⁹³

E. Contract Termination and Cancellation

The CLC lists seven conditions that allow the

187. See FARNSWORTH, *supra* note 129, § 4.21. In American law, this is known as the "pre-existing duty rule" and has been widely criticized. *Id.*

188. U.C.C. § 2-209(1) (2001).

189. *Id.*

190. CLC art. 79.

191. *Id.*

192. *Id.* art. 80.

193. U.C.C. § 2-210(2) (2001).

rights and obligations of a contract to be terminated.¹⁹⁴ The first is where debt obligations have been performed in accordance with the terms of the contract. The second is where the contract has been rescinded. The third is if a debt can be offset, this also can lead to termination. The fourth, a recent addition which may prove to be convenient to the obligor, creates termination when the obligor deposited the object according to law. The fifth and sixth conditions relate to creditors. A contract is terminated when a creditor exempts debt or the creditor's right and debt obligations are assured by the same person. The above six situations are illustrative but not exhaustive. The final condition is a remedial clause that states that other situations provided by law or agreed to by the parties may also cause termination. Unlike the U.C.C. or CISG, the CLC emphasizes good faith even after a contract has been terminated.¹⁹⁵ According to course of dealing, a party shall execute the obligations such as providing notice and assistance, and maintaining secrets.

In China, there are two modes of canceling a contract: unilateral cancellation and bilateral cancellation. Article 94 of the CLC provides that a party may cancel a contract under the following circumstances: 1) if the purpose of the contract cannot be achieved due to force majeure; 2) if the counter-party expressly indicates, or his conduct indicates, that he will not honor his debt before the due date of performance; 3) if one party to the contract delays in performing the principal debt obligations and fails, after being urged, to perform them within a reasonable time period; 4) if the purpose of the contract cannot be achieved due to late performance or other act of breach; and 5) if other situations promulgated by law.¹⁹⁶

After cancellation, a party who has performed the contract may claim damages, restitution, or other relief.¹⁹⁷ Under the U.C.C., the canceling party retains any remedy for breach of the whole contract or any unperformed bal-

194. See CLC art. 91(1)-(7).

195. *Id.* art. 92.

196. *Id.* art. 94.

197. *Id.* art. 97.

ance.¹⁹⁸ It is the same in China, where under the CLC the canceling party reserves all rights of remedy.¹⁹⁹

F. Liability for Breach of Contract

Chapter VII of the CLC focuses on liability for breach of contract. Where one party to a contract fails to perform its obligations or its performance fails to satisfy the terms of the contract, that party shall bear liabilities for breach of contract such as continuing to perform its obligations, taking remedial measures, or compensating for losses.²⁰⁰ Article 113 states:

Where one party to a contract fails to perform the contract obligations or its performance fails to satisfy the terms of the contract and causes losses to the other party, the amount of compensation for losses shall be equal to the losses caused by the breach of contract, including the interests receivable after the performance of the contract, provided it does not exceed the probable losses caused by the breach of contract which has been foreseen or ought to be foreseen when the party in breach concludes the contract.²⁰¹

Like the U.C.C. and CISG, the purpose of the law is to put the aggrieved party in the position he would have been in had the breaching party performed the contract. The CLC also requires the aggrieved party to mitigate losses with reasonable effort.²⁰²

Unlike the U.C.C., however, the CLC contains no specific provisions to explain precisely the exact measure of monetary damages. The CLC does not provide a more detailed method to measure damages. Article 112 states that where one party to a contract fails to perform a contract obligation or its performance fails to satisfy the terms of the contract, the party shall, after performing its obligations or taking remedial measures, compensate for the losses, if the other party suffers from other losses.²⁰³ Again, the CLC does not explain the meaning or scope of

198. U.C.C. § 2-106(4) (2001).

199. CLC art. 97.

200. *Id.* art. 107.

201. *Id.* art. 113.

202. *Id.* art. 119.

203. *Id.* art. 112.

"other losses" in this section, which can be considered a clear drawback. From Article 113 we can infer that "other losses" can include both direct and consequential losses. Since there is no detailed rule in calculating damages, the question of uncertainty arises. The lack of a detailed measurement for damages and no legal concept of incidental and consequential damages make it very difficult for plaintiffs in China to get full recovery in a lawsuit. However, it seems clear that at least direct losses are recoverable.

Under the U.C.C., there are two types of market price remedies based on seller and buyer's breach.²⁰⁴ Article 109 of the CLC states that "[i]f either party fails to pay charges or remuneration, the other party may demand the payment."²⁰⁵ It is understood that the seller can ask for the price when the buyer has breached the contract. This seems to be the equivalent of the seller's action for the price under U.C.C. § 2-709. But under the U.C.C., the action for the price is now generally limited to those cases where resale of the goods is impracticable except where the buyer has accepted the goods, or where the goods have been destroyed after risk of loss has been passed to the buyer.²⁰⁶ The CLC lacks these limitations. Since there is no resale remedy for breach of a sales contract in China, the CLC does not provide that resale is a prerequisite for price remedy.

Turning to the buyer's remedies for breach of quality terms, CLC Article 111 announces that "[i]f the quality fails to meet the agreed requirements, liability for the breach of contract shall be borne in accordance with the agreement between the parties."²⁰⁷ If the contract lacks an agreement as to liability for breach of contract, or such agreement is unclear, or if it cannot be determined in accordance with the provisions of Article 61, the aggrieved party may, in light of the character of the object and the degree of losses, reasonably choose to request the other party to bear the liabilities for the breach of contract such as repairing, substituting, reworking, returning the goods

204. U.C.C. §§ 2-708, 2-713 (2001).

205. CLC art. 109.

206. U.C.C. § 2-709 (2001).

207. CLC art. 111.

or reducing the price or remuneration.²⁰⁸ Further, there is no detailed CLC rule to explain the proper way of reducing the price. Thus, the CLC's approach toward damages for quality defects also has much uncertainty.

By contrast, CISG Article 50 allows a reduction of the contract price in the proportion that the value of the non-conforming goods had on the date of delivery to the value that the goods would have had on the same date had it conformed to the contract.²⁰⁹ This method has long been familiar to civil law systems. U.C.C. § 2-714(2) utilizes another approach, but the language of § 2-714 has caused some problems in determining between the value of the goods accepted and as warranted.²¹⁰

The CLC provides that specific performance is still a possible remedy, but not a predominate one.²¹¹ In the past, specific performance was very important and was considered to be the remedy of first resort.²¹² Now, monetary damages are becoming the first choice. Only in some special situations do judges order specific performance; for instance, if two state-run companies sign a contract based upon a state plan, specific performance may be warranted. Under such circumstances, the judge will adjudicate specific performance other than money coverage.

IV. CONCLUSION

As discussed in the preceding Section, China has observed some good experiences of Western market countries, and made some substantial improvements in the development of its legal system, particularly in the area of contract law. This is most evident in China's amendment of the rule of offer and acceptance, creditors' subrogation and revocation rights, and establishment of uniform rules in the CLC. The CLC puts an end to the different and often conflicting principles and rules set forth in the three

208. *Id.*

209. CISG art. 50.

210. See Richard M. Alderman & Richard F. Dole, Jr., *Sales*, in 1 A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE 352-53 (1983).

211. CLC art. 111.

212. ECL 1993 art. 6. See also LAW IN THE PEOPLE'S REPUBLIC OF CHINA: COMMENTARY, READINGS AND MATERIALS 564 (Ralph H. Folsom & John H. Minman eds., 1989).

different contract laws it replaced. The unification under the CLC brings forth efficiency and implements new rules for the expanding needs of modern E-commerce. Further, the CLC is the first contract law in China to promulgate the rule to protect an aggrieved party's expectation interests.

Nonetheless, there are many uncertainties and difficulties in the new Chinese contract law. It is regrettable that the CLC does not include further steps to enforce the principle of expectation interests. As discussed above, there are no market price rules to recover contract damages. Remedies as a whole remain very vague, and seem less significant than many of the other legal issues addressed within the CLC. The remedy provisions have been put into the general provisions of the CLC, but there are many different types of contracts in the subdivisions of the law. It is not easy to set out a lucid and clear remedy rule for various breaching situations. A better approach may have been to put tailored remedy rules into different contract rule subdivisions. In addition, some provisions in the CLC grant judges great discretion. Since case law is not a legal source in China, this will raise further difficulty for judicial practice and uniformity. Potential problems related to drafting and legislative skill may also arise.

From all perspectives, though, the newly established Chinese contract law is a great achievement. The CLC will bring clearer guidance for China's rapidly developing market economy, as unification is the first important goal to pursue. It is this law that ends the former chaotic state of contract law in China and will keep proper pace with the development of a market economy. Having examined other countries' civil and common law systems, drafters of the CLC absorbed some of the essence of these two legal families. Finally, the CLC brings China more in line with international commercial standards and creates greater access for foreign investors who are eager to enter the country's vast markets.

This is a new era in the history of contract law in China. In order to keep a harmonious pace with the inherent requirements of a market economy, the pursuit of efficiency is the ultimate goal. It is clear that Rome was

not built in one day. The new CLC is a significant step and a major achievement in the history of Chinese contract law.

