# THE CODE OF CONTRACT LAW OF THE PEOPLE'S REPUBLIC OF CHINA AND THE VIENNA SALES CONVENTION

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## INTRODUCTION

China is one of the original signatories to the United Nations Convention on Contracts for the International Sale of Goods ("Convention" or "Vienna Sales Convention").[1] Recently, however, China adopted the Code of Contract Law of the People's Republic of China ("Code" or "Code of Contract Law")[2] that applies to contracts for the sale of goods, including the international sale of goods that may or may not be subject to the Convention.

The Ninth National People's Congress ("NPC") adopted the Code at its Second Session on March 15, 1999. The passing of the Code was a long-awaited event. Several drafts of the Code were published in China in the 1990s and they solicited extensive interest from varied segments of the Chinese community. Criticism of the contents from certain sections of the community, however, generated rumors that a draft of the Code would not be presented for approval by the NPC at the Second Session.

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1 . United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, S. Treaty Doc. No. 98-9, 1489 U.N.T.S. 3, U.N. Doc. A/CONF. 97/18, Annex 1, *reprinted in* 19 I.L.M. 668 (1980) [hereinafter Vienna Sales Convention].

2 . *See* CODE OF CONTRACT LAW (P.R.C), *translated in Contract Law of the People's Republic of China,* CHINA L., June 5, 1999, at 86 [hereinafter C. CONT. L.].

This Essay discusses some imperfections of the present Code of Contract Law and compares the provisions of the Code concerning sale of goods with those of the Convention to determine their relative consistency. This Essay also investigates the possibility of conflict between the Code and the Convention under the present legal system of the People's Republic of China ("PRC"). Notwithstanding the foregoing flaws, the Code took effect on October 1, 1999. Accordingly, the new features of the Code will also be discussed, describing the characteristics and operation of the Code of Contract Law in China.

# I. CODIFICATION OF CONTRACT LAW AND THE ISSUE OF UNIFORMITY

## A. LEGAL TRADITION AND THE CODE OF CONTRACT LAW

Mainland China's legal system is similar in large part to the continental law adopted in France, Germany, Japan, and Taiwan. Codes of law that ensure uniformity in legislation are preferred in such legal systems. Contract law is regarded as an independent branch of law in both the common law and continental law tradition. While the common law tradition builds its contract law on the combined basis of case law precedent and statutes, the continental law tradition places contract law under the broader subject heading of civil and commercial law. Achieving uniformity and building a legal framework for a system that demonstrates a logical connection between "the tree and branches," are among the motivations and goals of the codification of laws in China. The codification of the Code is consistent with this East-Asian concept of the continental model.

Ideally, under the continental law model, a state will first develop a foundation of law before moving to specific rules. The legal reform movements carried out at the end of nineteenth century by the Qing Dynasty in China are a good demonstration of the foregoing. A more recent illustration is the passage of the Code of the General Principles of Civil Law ("GPCL")[3] in 1986, which represents the half of the Code of a Civil Law that is intended to cover all legal relation-

3. CODE OF THE GENERAL PRINCIPLES OF CIVIL LAW (P.R.C.), *translated in* 34 AM. J. COMP. L. 715 (1986) [hereinafter C. CIV. L.].

ships of civil and commercial nature in the PRC by providing both general principles and specific rules. In a period of China's history, when the guidance of legal principles is vital in order to deal with the multitude of legal relationships created every day in China, such a comprehensive code of civil law, requiring a process of thorough deliberation and extensive consultations, has proven impossible to implement. Consequently, to date, China's civil law code only consists of general principles.

For similar reasons articulated, a code of contract law was not possible in the 1970s and 1980s when China increasingly began to open its doors to the outside world and carried out wide economic reforms throughout the country. Rules of contract law were developed in China between the 1970s and 1980s without a systematic foundation of contract theory. Prior to that time, contract law had no official role in the planned economy and state-controlled market. In order to meet the practical needs of the economic reform, three laws were formed. First, in 1981, the Economic Contract Law of the PRC[4] was established, which largely applies to contracts between Chinese parties. Soon after, in 1985, the Foreign Economic Contract Law[5] was passed, which applies to contracts involving a foreign party. Finally, in 1987, the Technology Contract Law[6] was passed, which regulates the transfer of technology between Chinese parties. These three laws together formed the basis for more than a dozen by-laws, regulations, rules, and measures to regulate various aspects of contract law in the PRC, or various types of contracts. A lack of uniformity, certainty, and clarity, however, became a serious issue among all these laws and regulations, thereby threatening stability, efficiency, and fairness in commercial transactions. A number of gray areas existed because the "tree and branches" of the contract law were not logically connected. In the absence of general principles in many crucial areas of contract law, commercial relationships were placed in limbo. The

4. ECONOMIC CONTRACT LAW (P.R.C.), *translated in* 22 I.L.M. 330 (1983) [hereinafter ECON. CONT. L.].

5. FOREIGN ECONOMIC CONTRACT LAW (P.R.C.), *translated in* 24 I.L.M. 799 (1985) [hereinafter FOREIGN ECON. CONT. L.].

6. TECHNOLOGY CONTRACT LAW (P.R.C.), *translated in China Law* (visited Sept. 4, 1999) <http://www.qis.net/chinalaw/prclaw21.htm> [hereinafter TECH. CONT. L.].

abuse of judicial power became an inevitable by-product of such an insufficient system. The NPC passed the Code in order to address the foregoing issues and to create an ideal and uniform mechanism of contract law in mainland China.

The Code of Contract Law consists of 428 articles in total, making it the second largest statute in China after the Code of Criminal Law of 1997, which consists of 452 articles. The Code of Contract Law is meant to cover all issues of contract law and, in particular, abolishes the distinction between the foreign related contract and the domestic contract.[8] This feature is very important to foreign companies and businesspersons, including those from Hong Kong, Macau, and Taiwan, who are equally subject to the Foreign Economic Contract Law.

The Code of Contract Law can be broadly divided into two parts: the General Principles and the Specific Rules. The first part contains eight chapters, setting out the general principles of contract law in the PRC. The second part consists of fifteen chapters, which represent the "branches" or "limbs" of the contract law and includes provisions to regulate contracts for the sale of goods,[9] including but not limited to the following: contracts for supply and use of electricity, water, gas, or heating;[10] donations;[11] loans;[12] leases;[13] construction;[14]

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7. CODE OF CRIMINAL LAW (P.R.C.), *translated in* Charles D. Paglee, *China law Web- PRC Criminal Law* (last modified Apr. 7, 1998) <http://www.qis.net/chinalaw/prclaw60.htm> [hereinafter C. CRIM. L.].

8. *See* C. CONT. L., *supra* note 2, art. 428 (announcing that on the date the Code of Contract Law of the PRC came into effect, both the prior domestic and foreign economic contract laws were rendered invalid and superseded).

9. *See id.* arts. 130-75 (defining the scope of the regulation and setting forth provisions regulating the sale of goods).

10. *See id.* arts. 176-84 (setting forth contractual obligations).

11. *See id.* arts. 185-95 (regulating contracts where one party has made a gift, for no consideration to the other party (the donee) who accepts the gift).

12. *See id.* arts. 196-211 (defining a loan contract and setting forth the obligations of the parties to such a contract).

13. *See* C. CONT. L., *supra* note 2, arts. 212-36 (setting forth the law pertaining to contracts for leases).

14. *See id.* arts. 251-68 (regulating work contracts for services performed).

the performance of specific works;[15] transportation;[16] technology;[17] storage;[18] warehousing;[19] commission;[20] brokerage;[21] and intermediation.[22]

The categories of specific contracts listed in the Code reflect Chinese perceptions of contracts and contractual relationships in commercial transactions. These categories differ from the common law approach to the categorization of contracts. For example, a contract code in the common law tradition would probably not differentiate a contract for warehousing from a contract for storage; or a contract for commission from a contract for brokerage or intermediation. Common law jurisdictions may, nevertheless, employ compatible expressions. It is also unlikely that a common law jurisdiction would regard a contract for the performance of work or a contract for the development of technology as a special category of contract. The problem is deciding whether it is reasonable and practical for a statute to list exclusively all types of contracts which may emerge in commercial practice; and, moreover, whether it is possible for the specified categories to cover all variations of contractual relationships arising from commercial reality. The Code leans heavily towards the continental law tradition in that it attempts to rationalize the system of contract law by dividing contract law into either gen-

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15. *See id.* arts. 269-87 (including the regulation of design, survey, and project construction contracts).

16. *See id.* arts. 288-321 (regulating transportation contracts between carriers and passengers or shippers of goods).

17. *See id.* arts. 322-64 (covering contracts for the development and transfer of technology, as well as contracts for consultation of a technical nature and the provision of specific technical expertise).

18. *See id.* arts. 365-80 (regulating contracts between storing and safekeeping parties).

19. *See* C. CONT. L., *supra* note 2, arts. 381-95 (defining the relationship between storing and safekeeping parties to a warehousing contract).

20. *See id.* arts. 396-413 (covering contracts between principals and agents wherein it is agreed that the agent will act for the principal).

21. *See id.* arts. 414-23 (outlining the duties owed by parties to a brokerage contract, under which a broker trades for the principal with the principal's money).

22. *See id.* arts. 424-27 (regulating transactions involving the use of a "middle man").

eral principles or specific rules; and furthermore establishes a relatively comprehensive and exclusive list of specific contracts in China. The effectiveness of this system remains unproven. The Code acknowledges the difficulty inherent in establishing a truly exclusive list of specific contracts and provides for the regulation of contractual relationships that do not fall under any of the fifteen types of specific contract.[23] The latter provision in Article 124 of the Code is expected to achieve the goal of uniformity in the contract law of the PRC.

### B. UNIFORMITY UNDER THE CODE OF CONTRACT LAW?

When the Code came into force on October 1, 1999, certain contract laws ceased to operate.[24] The Code, therefore, attempts to unify contract law based on three separate statutes; however, it is questionable whether the Code can actually achieve the uniformity of contract law in the PRC.

The foregoing issue of uniformity must be examined by referring to the meaning of "contract" under the Code. Article 2 of the Code expressly states that contract refers to an agreement made between subjects of equal footing, including natural persons, legal persons, and other organizations, for the purpose of establishing, changing, or terminating certain relationships based on civil rights and obligations.[25] Certain relationships, however, are excluded from this definition, including those agreements affecting the status of a person or the relationship between persons, such as marriage, adoption, and guardianship, which are regulated by other laws.[26] The definition of contract under Article 2 extends to many contractual relationships that fall outside of the aforementioned specific categories of contract.

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23. *See id.* art. 124 (stating that where a contract does not fall within one of the specific laws, it should be dealt with either through the General Provisions in the first part of the Code, or by applying the specific contractual provisions that come closest to meeting the characteristics of the contract in question).

24. *See* C. CONT. L., *supra* note 2, art. 428 (declaring that with the coming into force of the Code, three existing codes would cease to have effect: the Economic Contract Law, the Foreign Economic Contract Law, and the Technology Contract Law).

25. *See id.*

26. *See id.*

Examples include: settlements between disputing parties for the purpose of resolving their dispute; contracts between Chinese and foreigners, including Hong Kong, parties for the establishment of joint equity ventures in China; and contracts between private institutions or individuals with private students for the purpose of providing educational services. Similarly, a contractual relationship may exist between a public university and one of its students under Article 2, though such contractual relationship is not expressly regulated in the Code. Can the Code deal with these contractual relationships effectively?

It may be argued that a concept of "general contract," as opposed to the fifteen types of "specific contracts" identified in the Code exists in Article 2 of the Code. As noted above, Article 124 of the Code deals with all contracts that fall outside the specific provisions. If there is no special law regulating such contracts, they are subject to the general principles set forth in the Code, or can be dealt with by analogy to the contract rules applicable to the specific contracts.[27] Whenever appropriate, such contracts may also be dealt with by analogy to the "other" relevant laws.[28] Wide and flexible judicial discretion should be expected in the application of Article 124. Depending on the nature of the contractual relationship, the court may sometimes face a situation where the Code does not provide definite guidance. For example, a court may have difficulty where the agreement is for the settlement of a dispute reached during negotiation or mediation; or, where there may be conflicting or inconsistent principles between the Code and other relevant laws, such as a contract for the establishment of a joint equity venture.

These ambiguities result in a multitude of questions including the following. Should a contract for the establishment of a joint equity venture be subject to the Code of Contract Law? If so, what is the relationship between the Code and the Joint Equity Venture Law? Can the relationship between the Code and the Joint Equity Venture Law be compared with the relationship between the Code and the Companies Law because a contractual relationship exists among the

27. *See id.*

28. *See* C. CONT. L., *supra* note 2; *see also infra* notes 67-68 (speculating on the identity of the "other laws").

shareholders of a company set up under the Companies Law? Given the existence of these unexplored issues, it may be argued that the Code has not actually achieved complete uniformity in the contract law of the PRC. At a minimum, however, it is evident that limited uniformity is achieved by the Code, thoroughly unifying of the three former contract statutes in China.[29]

## II. THE RELATIONSHIP BETWEEN THE VIENNA SALES CONVENTION AND THE CODE OF CONTRACT LAW

China ratified the Vienna Sales Convention in 1986 and it remains in force in the PRC today. In the event of an inconsistency between the Convention and the Code, the Convention prevails.[30] This principle of Chinese civil law forms the basis for resolving any inconsistency or contradiction between an international convention and the Chinese domestic law in question. It also defines the relationship between the Convention and the Code. The relationship is twofold: in the case of inconsistency, the Convention prevails; and in the absence of inconsistency, the Convention supplements the Code. The meaning of "inconsistency" arises as an important issue. Should "inconsistency" include both "direct and indirect," or alternatively both "express and implicit" inconsistencies? The supplementary relationship between the Convention and the Code, and the uncertainty in the meaning of "inconsistency" give rise to a need for a comparative study of the Convention and the Code.

In general, the Vienna Sales Convention applies to a contract of sale between parties from different countries,[31] and the Code of Contract Law applies to both contracts between two parties carrying on businesses within the territory of the PRC and contracts between

29. *See* C. CONT. L., *supra* note 2.

30. *See* C. CIV. L., *supra* note 3, art. 142 (providing that in the event that inconsistent provisions exist, international treaties, ratified or acceded by the PRC, prevail over domestic laws concerning civil matters). If, however, the inconsistency is subject to a reservation to the international treaty made by the PRC at the time of ratification or accession, the domestic provision prevails. *See id.*

31. *See* Vienna Sales Convention, *supra* note 1, art. 1(a) (defining the sphere of application of the Vienna Sales Convention).

parties from different countries.[32] Provisions of the Convention and the Code may overlap to some extent. The operation of the Convention, however, does not preclude the operation of the Code in all circumstances. In fact, the Code may provide supplementary rules to the Convention where the Convention either: (1) expressly excludes coverage of certain matters;[33] (2) is silent with regard to an area covered by the Code;[34] or (3) where the PRC has varied the provisions of the convention to give effect to the operation of certain provisions of the Code.

Uncertainty in the meaning of "inconsistency" can also lead to joint operation of the Convention and Code in certain circumstances. For example, Article 21 of the Convention regulates the effect of a late acceptance of an offer. Under this provision, a late acceptance is effective if the offeror promptly informs the offeree of the former's intention to accept the late acceptance.[35] On the other hand, if the offeror fails to respond to the late acceptance, the late acceptance is deemed to be invalid.[36] Article 28 of the Code of Contract Law also regulates the effect of a late acceptance and, in effect, gives rise to a presumption that a late acceptance not accepted by the offeror constitutes a new offer.[37] It is questionable whether this provision is consistent with Article 21 of the Convention for the two provisions can

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32. *See generally* C. CIV. L., *supra* note 3, art. 142 (setting forth the choice of law rules).

33. *See, e.g.,* Vienna Sales Convention, *supra* note 1, art. 4(a) (providing that the Vienna Sales Convention is not concerned with determinations involving the validity of contractual provisions, such as exclusion clauses or of any commercial usage). Moreover, the Vienna Sales Convention expressly removes itself from consideration of the issues regarding the transfer of property in the goods sold. *See id.* art. 4(b).

34. *See, e.g.,* C. CONT. L., *supra* note 2, art. 16 (discussing a mode of receipt of offers, data-telex, which the Vienna Sales Convention does not address).

35. *See id.* art. 21(1) (noting that the offeror may express his or her intention to accept the offeree's late acceptance either orally or through other means).

36. *See id.* (implying that without the offeror's acceptance, the offeree's late acceptance is ineffectual).

37. *See id.* art. 28 (providing that late acceptance by the offeree is regarded as a new offer, unless the offeror informs the offeree promptly of the former's acceptance of the late acceptance).

lead to different consequences if more communications between the parties follow the dispatch of the late acceptance. Legal liability may arise under the Code, from the new offer and subsequent communications between the parties. Whether or not the possibility of such consequence amounts to inconsistency between the Convention and the Code is unclear. Overlapping between the Convention and the Code or joint operation between them is possible in such cases. Accordingly, the position of priority to the Convention, granted in Article 142 of the GPCL, may not offer answers to all possible relationships between the Convention and the Code. This Essay compares the Convention and the Code to examine both the consistencies and inconsistencies in terms of supplementary functions between them.

## III. THE MAKING OF A CONTRACT OF SALE UNDER THE CODE OF CONTRACT LAW

### A. OVERVIEW

The making of a contract involves several aspects of contract law: the capacity of the parties to make a contract, the process of negotiating a contract, and the validity of a contract. The Vienna Sales Convention regulates the process of negotiating a contract, while the Code of Contract Law regulates the capacity and validity issues. The Code addresses the various matters affecting the formation of contracts in Chapter Two.[38] These provisions are meant to serve as the general principles, not only to contracts for the sale of goods, but also to any other contracts regulated by the Code. In this sense, the Code provisions affecting contract formation are much more detailed than their counterparts in the Convention, where only ten articles regulate the formation of contract.[39] The sections of the Code that regulate the validity of contracts,[40] including the capacity to contract,

38. *See id.* arts. 9-43.

39. *See* Vienna Sales Convention, *supra* note 1, arts. 14-24 (setting forth the requirements under the Vienna Sales Convention for the proper formation of a contract).

40. *See* C. CONT. L., *supra* note 2, arts. 44-59 (providing the factors that must be used to determine whether a contract was established under the law and should be given effect).

do not have a counterpart in the Convention.

### B. CAPACITY TO CONTRACT

The capacity to contract under the Code is regulated by Articles 2, 9, and 47 through 50. These provisions are supported in large part by the applicable provisions of the GPCL,[41] which regulate the capacity of a natural person[42] and the capacity of a legal person.[43] "Other organizations" which can be a contracting party under Article 2 of the Code are not defined in the GPCL, seeing that it covers only the organization that meets the requirements for a legal person under Chinese law. Attempts to define the capacity of such organizations may therefore result in disagreement. The absence of adequate definition creates some uncertainty in the application of the Code of Contract Law.

The capacity to contract under the Code of Contract Law may be discussed from three perspectives: capacity of a natural person, capacity of a legal person, and capacity of other organizations.[44] The following is a summary of the capacity of the three aforementioned contracting party types based on an analysis of the GPCL and the Code. First, a natural person of at least eighteen years of age who does not suffer any mental disability is capable of entering into a contractual relationship on his or her own free will.[45] The threshold age may, in certain circumstances, be reduced to sixteen years,[46] and

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41. *See* John Mo, *General Principles of Civil Law, in* CHINESE LAW 95 (Wang Guiguo & John Mo eds., 1999) (discussing, in depth, the civil capacity of a natural or legal person under the GPCL and a general review of the GPCL).

42. *See* C. CIV. L., *supra* note 3, arts. 9-15 (covering the capacity of minors and individuals with mental illness).

43. *See id.* arts. 36-53 (regulating the capacity of organizations, as well as state-owned and other enterprises).

44. *See* C. CONT. L., *supra* note 2, art. 2 (stating that a contract can be made between these individuals or entities).

45. *See* C. CIV. L., *supra* note 3, art. 11 (noting that eighteen year-olds are considered adults with the ability to perform civil acts independently). *See generally* C. CONT. L., *supra* note 2, art. 9 (stating that "parties shall have appropriate civil capacity of right and civil capacity of conduct.").

46. *See* C. CIV. L., *supra* note 3, art. 11 (providing that a sixteen year-old that supports himself or herself financially is deemed competent for the purpose of en-

even be as low as ten years old.[47] A similar rule is present in the common law principles of contract relating to purchase of necessaries by a minor.[48] Children under ten years of age are deemed, however, to have no capacity to contract in the PRC.[49] The fixed threshold of ten years old differentiates the Chinese law governing the capacity of a minor from the comparable common law rules where such a definite threshold is not found. A person with "limited civil capacity" is only capable of understanding the nature and consequence of some of his or her own acts and may enter into certain contractual relationships appropriate to his or her mental state.[50] The validity of a contract made by such a person is normally conditioned on the retrospective approval of the person's legal agent or guardian, unless the contract is merely beneficial to such person or is appropriate for his or her age, intelligence and mental state.[51] A natural person who is represented by an agent in the making of a contract is not liable for any act of the agent that exceeds the agent's authority,[52] unless the act is supported by an ostensible authority that was reasona-

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tering into a contract).

47. *See id.* art. 12 (implying that a ten year-old may conclude certain contracts suitable for one of his or her age and intelligence).

48. *See generally* Fawcett v. Smethurst, 84 L.J.K.B. 473 (1914) (holding that a minor who rented a car that was damaged in his care was not liable to its owner because of "onerous," a contract term placing the car at the minor's risk; absent this term, the court said, the hiring of the car, if considered necessary, thereby created liability for the minor defendant); *see also* Ryder v. Wombwell, 4 L.R.-Ex. 32 (1868) (holding that a minor who had not paid for items of jewelry and a goblet supplied to him was not liable for their value to the plaintiff because they were not "necessaries"). The Wombwell court discussed the general rule of law in England that an infant cannot bind himself by contracting with another, unless the contract is one for "necessaries." *See id.* at 38.

49. *See* C. CIV. L., *supra* note 3, art. 12 (requiring that children below the age of ten years must in all circumstances have legal representation).

50. *See id.* art. 13 (requiring that in all other contractual transactions, the person of limited competence must be represented by his or her legal representative).

51. *See* C. CONT. L., *supra* note 2, art. 47 (providing that a good faith contracting party may withdraw from his or her contract with a person of "limited civil capacity" before the contract is ratified).

52. *See id.* art. 48 (including those acts by an agent whose term of agency had expired at the time of contract).

bly relied upon by a bona fide third party.[53] The presumption of an ostensible authority in the Code of Contract Law is an innovation in the principles of agency law and appears to have no basis in the GPCL which is deemed to be the foundation for all civil and commercial laws in the PRC.[54] Amendment of the GPCL's rules of agency may only be a matter of time. The foregoing principles also determine whether a contract governed by the Vienna Sales Convention, which is silent on these matters, was made by persons with the capacity to contract.

Second, a legal person under Chinese law is an organization that is capable of enjoying and exercising civil rights, as well undertaking and performing civil duties independently.[55] A legal person, therefore, must: (1) be established pursuant to the law;[56] (2) have the necessary property or funds;[57] (3) have its own name, organization, and place of business;[58] and (4) be capable of undertaking civil liability independently.[59] A legal person can be an institution set up under the relevant law; or alternatively, one that meets the aforementioned requirements.[60] A legal person may also be required to register with the relevant government authority if the law so prescribes.[61] A partnership or a joint operation constituting a new economic entity and satisfying the four requirements shall be regarded as a legal person un-

53. *See id.* art. 49 (stating that an act of an agent, done without appropriate authority and falling outside authority or after the expiry of authority, is valid if it is reasonable for the party dealing with the agent to believe the existence of a valid authority).

54. *See* C. CIV. L., *supra* note 3, arts. 16-19, 63-70 (setting forth the rules of agency and guardianship in the GPCL).

55. *See id.* art. 36 (noting that a legal person may contract with others immediately upon its inception; and, conversely it loses the right to contract upon its termination).

56. *See id.* art. 37(11) (stating the first of four factors that must be satisfied before an entity can be classified as a "legal person").

57. *See id.* art. 37(2).

58. *See id.* art. 37(3).

59. *See* C. CIV. L., *supra* note 3, art. 37(4).

60. *See id.* art. 50 (noting that all government agencies, unlike all institutions or associations, enjoy automatic "legal person" status upon their establishment).

61. *See id.*

der Chinese law.[62] The capacity of an entity to contract depends, to a great extent, on its ability to satisfy the requirements of a legal person under Chinese law. Only the companies and organizations that meet the description of "legal person" may act as legal persons in China. The legal person's capacity to contract may be affected by its scope of business as registered or approved by the relevant authorities. A contract for international sale may be declared void if the Chinese party does not have the so-called "foreign trading right." A domestic contract for the sale of goods may also be declared void if the business scope of a party does not cover the goods sold in the contract, or the parties do not have the capacity to perform the contract.[63] Although such reasoning may appear disconcerting to a common law lawyer, Chinese courts continue to treat the approved scope of business as an issue of capacity. This is because engaging in a business transaction outside the approved scope of business is regarded to be illegal in most circumstances. Similarly, a settlement agreement reached during the mediation process conducted by a court may be set aside by that court if the agreement requires a party to perform an act falling outside its scope of business.[64] The above

62. *See id.* art. 51 (acquiring status as a legal person is conditioned upon the competent authority's approval and registration).

63. *See* 1 SELECTED CASES OF THE PEOPLE'S COURT 104-08 (Institute for Practical Legal Research of the National Supreme Court ed.) (Publishing House of the People's Court 1992) (in Chinese) (discussing the case of *Base Construction Corporation (Henan) of China Exported Commodities v. Foreign Trade Development Company of Shenzhen*). In *Base Construction Corporation (Henan) of China Exported Commodities v. Foreign Trade Development Company of Shenzhen*, the parties contracted to sell a quantity of mung bean and sesame seed. *See id.* The seller's supplier was prohibited from selling the products concerned by the local Administration for Industry and Commerce because the supplier did not have a license to sell the products. *See id.* Thus the contract was not performed. *See id.* The parties accused each other of breach of contract. The court of appeals held the contract to be unenforceable because the seller was incapable of performing its obligations under the contract and thereby ordered the parties to share the losses incurred. *See id.*

64. *See* LIN ZHONG, SETTLEMENT OF COMMERCIAL DISPUTES IN CHINA 203-04 (H.K. Joint Pub. Co. Ltd., 1998) (in Chinese) (discussing the case of *X Construction Company v. Trading Company of Shuchang*). In *X Construction Company v. Trading Company of Shuchang*, the defendant sold to the plaintiff 300 tons of coil steel in 1991 and the defendant delivered only 20 tons of coil steel, which did not meet contract description. *See id.* The court in 1992 mediated the dispute and the defendant agreed to deliver 280 tons of coil steel meeting the description. *See id.*

mentioned rules governing the contract made by an agent also apply to the contract where a legal person is the principal.[65] In addition, a legal person is also liable in contract to a bona fide contracting party who reasonably relied on the apparent authority of the legal representative or responsible person of the legal person.[66] The foregoing rules govern the legal person's capacity to contract in Chinese law.

Third, the Code recognizes the right of an organization, which is not a legal person to conclude a contract.[67] This is a new development in the civil law of the PRC. The GPCL only recognizes two types of entities as subjects of civil rights, natural or legal persons.[68] The GPCL thereby implies that an organization that is not a legal person is incapable of performing an act of civil law. While Article 2 of the Code permits "other organizations," besides a natural or legal person, to conclude a contract, the meaning of "organization" in this context is unclear in the Chinese jurisprudence. It is possible that "organization" refers to a government organization or any other social, political, or economic organization that enters into a commercial contract with another party. The organization must be allowed to enjoy the relevant right and be required to undertake the relevant liability for the purpose of ensuring stability and fairness in commercial transactions. Article 2 of the Code suggests that a government organization or department engaged in a commercial activity may be liable to the other contracting party,[69] even though this proposition

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Later the defendant failed to perform the agreement because it had no goods to deliver and the plaintiff applied to the court for a review of the settlement agreement under the review process of the court. *See id.* The court set aside the settlement agreement on the ground that the agreement was impossible to perform because the defendant's scope of business did not cover steel products. *See id.*

65. *See* C. CONT. L., *supra* note 2, art. 50 (defining the agency aspects of the legal person classification).

66. *See id.* (suggesting that a contracting party who "knows or ought to know" that the legal person's agent is not acting within his or her authority will not succeed in a claim against the legal person).

67. *See id.* art. 2 (identifying this group simply as "other" organizations).

68. *See* C. CIV. L., *supra* note 3, art. 54 (defining an act of civil law as the "lawful acts by which citizens or legal persons establish, modify or terminate civil rights and duties").

69. *See* C. CONT. L., *supra* note 2, art. 2.

has no basis in the GPCL. In relation to the contract made by an organization that is not a person, the Code provides guidance for ascertaining the legality of such a contract.

The foregoing discussion has focused upon the capacity to contract under the Code and the GPCL. Some of the rules are merely supplementary to the provisions of the Convention relating to the identity of the parties to a contract of international sale. If, for whatever reason however, the Convention does not apply to a particular contract of international sale, the applicable provisions of the Code and the GPCL apply exclusively to the contract.

### C. NEGOTIATION OF CONTRACTS

"Negotiation of contracts" refers to the whole negotiation process leading up to the conclusion of a contract. The process always begins with an offer, or invitation, followed by an acceptance or counter-offer, and ends with the conclusion of a contract. The Convention sets out specific rules on offer and acceptance.[70] In contrast to the common law rules on offer and acceptance, the Convention is more systematic, comprehensive, and certain. Articles 13 through 34 of the Code deal with the formality of offer and acceptance. In general, these provisions are similar to the relevant provisions of the Convention. It must be emphasized, however, that Article 10 of the Code adopted the same position as Article 11 of the Convention, giving effect to an oral contract which may or may not be supported by any written evidence. Article 10 of the Code states that a contract can be made between parties in written, oral, or any other form. Under this provision, the written form is required only when the relevant law expressly requires it or if the parties mutually agree.[71] This represents one of the crucial changes in Chinese contract law. Article 7 of the Foreign Economic Contract Law specifically states that a foreign economic contract must be made in writing. China made a reservation when it ratified the Convention to deny the effect of an oral contract.[72] This Chinese reservation to the Vienna Sales Convention

70. *See* Vienna Sales Convention, *supra* note 1, arts. 14-24 (regulating the formation of contracts under the Convention).

71. *See* C. CONT. L., *supra* note 2, art. 10.

72. *See Status of UNCITRAL Conventions and Model Laws* (visited Sept. 4,

should be amended consistently with the Code. The recognition of the oral contract increases flexibility in commercial transactions and makes the use of oral evidence possible in a dispute arising from a contract in the PRC. This change also reduces the difference between the common law contract rules, such as those practiced in Hong Kong, and the contract rules of mainland China with regard to the formation of contracts.

The provisions of the Code and the Convention governing the formation of contracts share several similarities, including the following: (1) both recognize written and oral contracts;[73] (2) both recognize telegram and telex as writing forms;[74] (3) both differentiate between an offer and an invitation;[75] (4) both give effect to an offer when it reaches the offeree;[76] (5) both permit an offer to be withdrawn if the withdrawal reaches the offeree before or at the same time as the offer;[77] (6) both permit an offer to be revoked if the revocation reaches the offeree before he or she dispatches an acceptance;[78] (7) both hold an offer irrevocable if the offer is irrevocable expressly or implicitly or if the offeree has acted by relying on a reasonable belief that the offer is irrevocable;[79] (8) both recognize that an acceptance may be made by a notice of statement, or any other

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1999), *available in* <http://www.jus.uio.uo/lm/un.conventions.membership.status/x.00-un.Contracts.International.Sale.of.Goods.Convention.1980.html> (recording the PRC's reservation of Article 1, para. (1)(b) and Article 11, in addition to other provisions relating to Article 11).

73. *Compare* C. CONT. L., *supra* note 2, art. 10, *with* Vienna Sales Convention, *supra* note 1, art. 11.

74. *Compare* C. CONT. L., *supra* note 2, art. 11, *with* Vienna Sales Convention, *supra* note 1, art. 13.

75. *Compare* C. CONT. L., *supra* note 2, art. 15, *with* Vienna Sales Convention, *supra* note 1, art. 14.

76. *Compare* C. CONT. L., *supra* note 2, art. 16, *with* Vienna Sales Convention, *supra* note 1, art. 15(1).

77. *Compare* C. CONT. L., *supra* note 2, art. 17, *with* Vienna Sales Convention, *supra* note 1, art. 15(2).

78. *Compare* C. CONT. L., *supra* note 2, art. 18, *with* Vienna Sales Convention, *supra* note 1, art. 13.

79. *Compare* C. CONT. L., *supra* note 2, art. 19, *with* Vienna Sales Convention, *supra* note 1, art. 16(2).

means agreed by or acceptable to the contracting parties;[80] (9) both state that an acceptance should reach the offeror within the stipulated time or within a reasonable time;[81] (10) both adopt the same criteria for the calculation of the period of time for acceptance;[82] (11) both regard a contract to have been made when the offeree's acceptance becomes effective;[83] (12) both permit an acceptance to be withdrawn before or at the same time when it reaches the offeror;[84] (13) both give the offeror a right to choose whether to accept a late acceptance;[85] (14) both adopt the same criteria for differentiating an acceptance from a counter-offer;[86] and (15) both adopt similar criteria for assuming the offeror's acceptance of insignificant modifications in the offeree's acceptance.[87]

Based upon these similarities, it is apparent that the Code is largely compatible with or similar to many provisions of the Convention. Arguably, most provisions of the Code regulating offer and acceptance are based on the model provisions of the Convention.

Such similarities between the Code and the Convention reflect a consistent approach that may be applicable to contracts of international sale in China. The differences between them, however, represent direct and indirect inconsistencies, which may not always be resolved by the prevalence of the Convention. The major differences

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80. *Compare* C. CONT. L., *supra* note 2, art. 22, *with* Vienna Sales Convention, *supra* note 1, art. 18(1).

81. *Compare* C. CONT. L., *supra* note 2, art. 23, *with* Vienna Sales Convention, *supra* note 1, art. 18(2).

82. *Compare* C. CONT. L., *supra* note 2, art. 24, *with* Vienna Sales Convention, *supra* note 1, art. 20(1)(a).

83. *Compare* C. CONT. L., *supra* note 2, art. 25, *with* Vienna Sales Convention, *supra* note 1, art. 23.

84. *Compare* C. CONT. L., *supra* note 2, art. 27, *with* Vienna Sales Convention, *supra* note 1, art. 22.

85. *Compare* C. CONT. L., *supra* note 2, art. 28, *with* Vienna Sales Convention, *supra* note 1, art. 21(1).

86. *Compare* C. CONT. L., *supra* note 2, art. 30, *with* Vienna Sales Convention, *supra* note 1, arts. 19(1), 19(3).

87. *Compare* C. CONT. L., *supra* note 2, art. 31, *with* Vienna Sales Convention, *supra* note 1, art. 19(2).

between the Code and Convention relating to the formation of contract are summarized below.

First, Article 10 of the Code recognizes the effect of a contract entirely or partly made in oral form. If other relevant laws and regulations require a special contract to be concluded in written form or the parties so agree, the contract must be made in writing. Article 11 of the Convention states that a "contract of sale need not to be concluded in or evidenced by writing and is not subject to any other requirement as to form." Since Article 2 of the Code makes an exemption to the general acceptance of an oral contract by referring to the special legislative requirements or the parties' preference to written form, the two provisions are not consistent on this particular point. China's reservation, which is a refusal of certain provisions of an international treaty or convention to Article 11 of the Convention, should be amended to reflect the present inconsistency between Article 2 of the Code and Article 11 of the Convention. In the case of inconsistency the reservation whose substance is yet to be clarified prevails over the relevant provision of the Convention.

Second, the Code expressly recognizes the use of Electronic Data Interchange ("EDI"), e-mail, written contract, postal letter, telegram, telex and fax as forms of writing,[88] but the Convention only specifically refers to telegram, telex,[89] written contract, and postal letter.[90] The Code includes specific forms of electronic data transmission or other means of modern communications that were not available when the Convention was drafted. A wide interpretation of the relevant provisions of the Convention would encompass such means of communication. Thus, the superficial differences between the Code and the Convention regarding the written forms of contract suggest that the Code is supplementary to the Convention for the purpose of ascertaining the formation of a particular written contract. In particular, Article 16 of the Code refers to the arrival time of an offer or

88. *See* C. CONT. L., *supra* note 2, art. 11.

89. *See* Vienna Sales Convention, *supra* note 1, art. 13; *see also* 'Case 1' *in* CASE STUDIES OF CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION, HONG KONG, FT LAW & TAX ASIA PACIFIC 1-6 (Guo Xiaowen ed., 1996) (holding that a contract partly concluded by fax was made in writing, despite the fact that the contract was said to be subject to the Vienna Sales Convention).

90. *See* Vienna Sales Convention, *supra* note 1, art. 20(1).

acceptance through EDI or the Internet and thus may be supplementary to the Convention, which does not regulate such matters.[91]

Third, the Code emphasizes the intention of a party sending a proposal to other parties in deciding whether the proposal is an offer or an invitation to make an offer.[92] The Convention emphasizes whether the proposal is sent to one or several specific persons for the purpose of determining whether the proposal is an offer or an invitation to offer.[93] The difference between them suggests the possibility that a proposal to the public may be regarded as an offer under the Code but as an invitation to an offer under the Convention. In such a case of inconsistency, the Convention prevails.

Finally, the Code permits an offer to be revoked in pursuance of the relevant law, presumably regardless of whether or not it was accepted by the offeree.[94] In comparison, there is no compatible provision under the Convention.[95] Accordingly, there is an indirect conflict between the Code and the Convention. Subsequently, an acceptance that is regarded as valid under the Convention may be regarded as invalid under the Code because of the revocation by the offeror in pursuance of law. Since this conflict does not fall under any reservation taken by China when they ratified the Convention, the relevant provisions of the Convention prevail where different consequences flow from the relevant provisions of the Code and the Convention.

These major differences between the Code and the Convention relating to the formation of contract have been identified above. As previously discussed, although the provisions of the Convention prevail in most circumstances, certain provisions of the Code are supplementary to the Convention because of the absence of any directly inconsistent rules in the Convention. In terms of written contract, the Code still denies the validity of an oral contract in special but limited circumstances. Such inconsistency with the Convention can be justified by the reservation of China when ratifying the Convention.

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91. *See* C. CONT. L., *supra* note 2, art. 16.

92. *See id.* art. 15.

93. *See* Vienna Sales Convention, *supra* note 1, art. 14(1).

94. *See* C. CONT. L., *supra* note 2, art. 20(2).

95. *See* Vienna Sales Convention, *supra* note 1, art. 4(a).

However, the reservation should be amended to reflect accurately the present position of Chinese law on the use of oral contract.

### D. VALIDITY OF CONTRACT

Validity of contract is not regulated by the Convention. In an international sale of goods in China, the issue is determined under relevant provisions of the Code, which set out the following rules: (1) a standard form contract is concluded when the parties sign or seal it;[96] (2) a contract made by way of postal letters, electronic data, or similar means is regarded as having been concluded when a letter of confirmation is signed;[97] (3) the place of contract is the place where the acceptance concerned becomes effective,[98] and in case of electronic date transmission, the recipient's principal place of business or permanent residence is regarded as the place of contract;[99] (4) the place of a standard form contract is the place where the contract is signed or sealed;[100] (5) an exclusion clause may be used in a standard form contract, but the party inserting the clause needs to draw the other party's attention to the clause in a reasonable manner;[101] (6) a standard exclusion clause is invalid if it excludes the liability of the party drafting the clause, increases the other party's liability and excludes the main right of the other party;[102] (7) an exclusion clause

96. *See* C. CONT. L., *supra* note 2, art. 32.

97. *See id.* art. 33 (setting forth a provision that may be interpreted as saying that if the parties intend to make a contract by way of any modern means of communications, they can sign a confirmation letter to evidence the conclusion of the contract). The language of Article 33, however, is ambiguous and should be rephrased. *See id.*

98. *See id.* art. 34 (contradicting Article 32, which provides that a written contract is concluded when the parties sign or seal it, but the contradiction may be overridden by Article 35 which regards the place of signature or seal as the place of a written contract); *see also id.* arts. 32, 35.

99. *See id.* art. 34.

100. *See id.* art. 35.

101. *See* C. CONT. L., *supra* note 2, art. 39.

102. *See id.* art. 40 (revealing a lack of clarity as to whether the three conditions are concurrent or alternative or whether the drafter of a standard exclusion clause is allowed to exempt his or her liability at all). Article 53, however, provides some reference for determining the validity of an exclusion clause. *See id.* art. 53.

purporting to exempt a liability arising from a personal injury claim or property damages caused by an intentional or reckless act is invalid;[103] and (8) a contract is invalid if it is made under fraud or duress, or in contravention of the State interest, is a result of a conspiracy to harm the interest of the State, the collective or a third party, or is used to disguise an illegitimate purpose, is harmful to public interest, is in contravention of law, regulations, and compulsory measures.[104]

While some of the above-mentioned rules parallel contract rules of common law, others do not. A detailed discussion of these rules will appear subsequently in this Essay under the heading "Major Features of the Code of Contract Law."

## IV. THE PERFORMANCE OF A CONTRACT UNDER THE CODE OF CONTRACT LAW

### A. OVERVIEW

Articles 60 through 76 and 130 through 175 of the Code regulate performance of a contract of sale. These provisions function similarly to the Sale of Goods Act in certain common law jurisdictions such as the United Kingdom and Australia. In Hong Kong, the compatible legislation is the Sale of Goods Ordinance. The PRC did not have a sale of goods law prior to March 1999 when the Code was promulgated. The Economic Contract Law,[105] the Foreign Economic Contract Law,[106] and the Technology Law[107] which are to be replaced by the Code do not govern the major issues of sale of goods, such as transfer of property, payment, delivery, transfer of risk and inspection of goods. The Code has changed this.

Contracts for the sale of goods are classified as the first of special types of contracts under the Code. For the purpose of comparison, the specific rules of the Code regulating contracts of sale can be divided into two main groups: those similar to the Vienna Sales Con-

103. *See id.* art. 53.

104. *See id.* art. 52.

105. *See generally* ECON. CONT. L., *supra* note 4.

106. *See generally* FOREIGN ECON. CONT. L., *supra* note 5.

107. *See generally* TECH. CONT. L., *supra* note 6.

vention and those different from the Convention. On the other hand, for the purpose of studying the specific rules governing contracts of sale, the rules should be examined according to the nature of the issue concerned, i.e., transfer of property, transfer of risk, conformity of the goods, fitness for purpose, merchantability of goods, delivery, payment and remedies, etc. This Essay discusses the specific rules relating to the contract of sale under the Code and the Convention according to the major issues concerned.

### B. THE TRANSFER OF PROPERTY

Transfer of property is not regulated by the Vienna Sale Convention. Thus, in a contract for the international sale of goods involving a Chinese party or a Chinese connection, the transfer of property is determined according to the relevant rules of the Code. The major rules of the Code governing the transfer of property are set out as follows: (1) the seller must have title in the goods to be sold or the right to sell it;[108] (2) unless stipulated in law the buyer knew or ought to have known the existence of a third party's interest in the goods sold,[109] the seller is obliged to guarantee that no third party will claim his or her right against the buyer over the goods sold;[110] (3) unless stipulated in law or agreed by the parties otherwise, the property in the goods sold passes to the buyer with the delivery of the goods;[111] (4) in a barter contract, the property in the goods bartered transfers to each other according to the terms of contract;[112] and (5) the parties may agree that the seller retains the property in the goods sold until the buyer pays the price of the goods or complies with other obligations.[113]

The above rules suggest that the property rights in goods sold normally transfer from the seller to the buyer according to the parties' agreement. These rules are largely consistent with the relevant

108. *See id.* art. 132.

109. *See* C. CONT. L., *supra* note 2, art. 151.

110. *See id.* art. 150 (proving to be largely identical to Article 41 of the Convention).

111. *See id.* art. 133.

112. *See id.* art. 175.

113. *See id.* art. 134.

rules of common law jurisdictions, except for the common law distinction between specific goods and unascertained goods, which refers to generic goods or goods capable of being replaced by each other. The Code, however, does not recognize the concept of unascertained goods.

### C. THE TRANSFER OF RISK

Transfer of risk in a contract for the sale of goods is regulated by Articles 142 through 149 of the Code and by Articles 66 through 70 of the Vienna Sales Convention. In comparing the two instruments, several similarities emerge, and are set out as follows: (1) the Code expressly states, and the Convention implies, that unless stipulated by law or agreed otherwise by the parties, the risk in goods sold is borne by the seller before delivery and is borne by the buyer after delivery;[114] (2) both state that the risk of damage or loss passes to the buyer as agreed if the buyer fails to take delivery according to the contract;[115] (3) both takes the position that unless agreed otherwise, the risk of damage or loss in the goods sold in transit transfers to the buyer at the conclusion of the contract;[116] and (4) both provide that in the absence of agreement, the risk passes to the buyer when the seller delivers the goods to the first carrier.[117]

Despite the above similarities, the Code and the Convention conflict in certain areas regarding the transfer of risk. Accordingly, when there is an explicit inconsistency between the Code and the Convention, the Convention applies. If, however, the Convention is silent as to a certain issue addressed in the Code or another implicit inconsistency arise, the rules of the Code may be supplementary to the Convention. To illustrate, the major differences between the Code and

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114. *Compare* C. CONT. L., *supra* note 2, art. 142, *with* Vienna Sales Convention, *supra* note 1, art. 67 (revealing approaches to the allocation of risk in a sales contract that are very similar).

115. *See* C. CONT. L., *supra* note 2, arts. 143, 146; *see also* Vienna Sales Convention, *supra* note 1, arts. 69(1), 69(2).

116. *See* C. CONT. L., *supra* note 2, art. 144; *see also* Vienna Sales Convention, *supra* note 1, art. 68.

117. *See* C. CONT. L., *supra* note 2, art. 145; *see also* Vienna Sales Convention, *supra* note 1, art. 67.

the Convention relating to the passing of risk are summarized as follows: (1) the Code does not differentiate between specific goods and unascertained goods as does the Convention;[118] (2) the Code specifically addresses the passing of risk by stating that the failure of the seller to pass the relevant documents and information to the buyer does not affect the transfer of risk,[119] while there is no compatible provision in the Convention; (3) the Code explicitly holds the seller liable for risk if the buyer chooses to terminate the contract on the ground that the goods do not conform with the contract,[120] but there is no compatible provision in the Convention; and (4) the Code states that the transfer of risk to the buyer does not affect the obligation of the seller to compensate the buyer for the buyer's loss caused by the seller's breach,[121] but the Convention states that loss of or damage "to the goods after the risk is passed to the buyer does not discharge him from his obligation to pay the price unless the loss or damage is due to an act or omission of the seller."[122]

The above-mentioned differences may lead to different consequences. In the case of unascertained goods, the absence of any rule in the Code means that the relevant rules of the Convention should be followed where a contract of international sale is involved. Article 147 of the Code, however, appears to be supplementary to the relevant provisions of the Convention because of a lack of direct or indirect inconsistency between them.[123] Generally speaking, the passing of relevant documents, such as documents of title, may affect the transfer of property, but the transfer of property and transfer of risk are usually separate in international transactions. Article 148 of the Code, which holds the seller liable for risk if the buyer terminates the

118. *See* Vienna Sales Convention, *supra* note 1, arts. 67(2), 69(3).

119. *See* C. CONT. L., *supra* note 2, art. 147; Vienna Sales Convention, *supra* note 1, arts. 30-52.

120. *See* C. CONT. L., *supra* note 2, art. 148.

121. *See id.* (setting forth the general transfer risk from the buyer to the seller and the effect on losses in case of breach).

122. Vienna Sales Convention, *supra* note 1, art. 66.

123. *See* C. CONT. L., *supra* note 2, art. 147 (comparing the text of Article 147 of the Code and the Vienna Sales Convention to show that they are similar and supplement each other).

contract on the ground of non-conformity of the goods, may cause disputes in international sales and domestic sales.[124] This is because technically the risk passes to the buyer in pursuance of the contract before the buyer decides to terminate the contract. A more logical rule would hold the buyer liable for the risk until the contract is terminated and the buyer claims compensation against the seller if he or she has suffered any loss. Such a rule would impose an obligation upon the buyer to take care of the goods in a reasonable manner. A buyer may abuse Article 148 of the Code by causing aggravated damage to the goods concerned because the risk will be eventually borne by the seller. Therefore, if Article 148 remains unchanged, arguably, there should be an express qualification to Article 148 that the seller is entitled to seek contribution from a buyer who has caused further damage to the returned goods. As Article 148 of the Code currently stands, there may be indirect inconsistency flowing from the application of the Code and the Convention to some cases.[125] Whether or not such indirect inconsistency is covered by Article 142 of the GPCL, which gives prevalence to the Convention, is unsettled in Chinese law.[126]

### D. THE CONFORMITY OF GOODS

Conformity of goods is always an important issue in the sale of goods. The Economic Contract Law, the Foreign Economic Contract Law, and Technology Contract Law require the seller to comply with the contract but do not provide specific rules governing the conformity issue. Interpreting the terms of the contract is the only way to determine whether the goods conform to the contract under the three laws of contract law. Very broad discretion and little legislative guidance is given to the court in adjudicating the conformity issue. In comparison, the sale of goods law in common law jurisdictions contains rules on fitness for purpose, merchantable quality, sale by description, and sale by sample, etc., thereby providing more detailed

124. *See id.* art. 148 (quoting Article 148 of the Code and arguing that the language of the provision may cause disputes between parties).

125. *See id.* (comparing the Code and the Vienna Sales Convention and arguing that there are inconsistencies between the two statutes).

126. *See* C. CIV. L., *supra* note 3, art. 142.

guidance for a court to make a decision. The Vienna Sales Convention is compatible with the common law practice in terms of the rules regulating the conformity issue. The Code, however, reduces the differences between the three contract laws and the common law rules or the provisions of the Convention with regard to the conformity issue by addressing the certain common issues concerning the conformity of goods and providing specific rules for dealing with them.[127] The Code, however, did not adopt the concept of "fitness for purpose" and "merchantable quality" as its counterpart in a common law jurisdiction although the concept of "quality" in the Code appears to overlap to some extent with the concept of merchantable quality.[128]

For the purpose of comparison, the similarities between the Code and the relevant provisions of the Convention regarding the conformity of goods are set out as follows: (1) both require the seller to provide goods conforming with the contract or specific descriptions;[129] (2) both require the goods to meet the general purposes or standards the goods of the same description are expected to meet in the absence of a specific agreement;[130] (3) both require the goods to be the same as the sample in a sale by sample;[131] and (4) both require the goods to be packaged or contained in a manner suitable for protecting or preserving the goods in the absence of an express agreement.[132]

The major differences between the Code and the Convention in relation to the conformity issue are as follows: (1) the Code does not regard fitness of the goods as an issue of conformity, but the Con-

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127. *See generally* C. CONT. L., *supra* note 2, arts. 62, 153, 156, 168, and 169.

128. *See id.* art. 62(1) (stating that in the absence of agreement, quality of the goods is to be determined according to the relevant national standard, professional standard, ordinary standard, or the special standard of the contract, as the case may require).

129. *See id.* art. 153; *see also* Vienna Sales Convention, *supra* note 1, art. 35.

130. *See* C. CONT. L., *supra* note 2, art. 62(1); *see also* Vienna Sales Convention, *supra* note 1, art. 35(2)(a).

131. *See* C. CONT. L., *supra* note 2, art. 168; *see also* Vienna Sales Convention, *supra* note 1, art. 35(2)(c).

132. *See* C. CONT. L., *supra* note 2, art. 156; *see also* Vienna Sales Convention, *supra* note 1, art. 35(2)(d).

vention treats fitness for "special purpose" as one of the issues of conformity;[133] (2) in the absence of an express agreement, the Code sets out an order of priority among applicable standards for ascertaining the quality or conformity of the goods, i.e., the national standard, the professional standard, the ordinary standard or special standard meeting the purpose of the contract,[134] but there is no compatible provision in the Convention; and (3) the Code specifically states that in a sale by sample that has a latent defect unknown to the buyer, the goods meeting the quality of the sample must also have the ordinary quality expected of goods of the same nature,[135] but there is no compatible provision in the Convention.

The aforementioned differences may or may not lead to inconsistency between the Code and the Convention, depending upon the circumstances involved. For example, in an international sale of goods governed by the Convention, the provisions of the Convention governing fitness for purpose apply even though there is no compatible provision in the Code.[136] Similarly, the order of priority among the applicable standards for the determination of the goods' quality may be used as an illustration of Article 35(2)(a) of the Convention, which requires the goods sold to be merchantable.[137] Since the Convention does not prohibit the determination of merchantability in such manner, there may not be inconsistency if Article 62(1) of the Code is relied upon for the purpose of providing assistance to the application of Article 35(2)(a) of the Convention. Article 169 of the Code requires that goods sold under a contract based on a sale by sample must also have the ordinary quality expected of goods of the same nature.[138] This may, however, cause an inconsistency between the Code and the Convention, because Article 35(2)(c) of the Convention only requires that the goods sold "possess the qualities of goods which the seller has held out to the buyer as a sample or

133. *See* Vienna Sales Convention, *supra* note 1, art. 35(2)(b).

134. *See* C. CONT. L., *supra* note 2, art. 62(1).

135. *See id.* art. 169.

136. *See* Vienna Sales Convention, *supra* note 1, art. 35(2) (delineating the criteria for goods satisfying the fitness of purpose standard).

137. *See id.* art. 35(2)(a) (defining "merchantability").

138. *See* C. CONT. L., *supra* note 2, art. 169.

model."[139] If a court considers the meaning of "qualities" under Article 35(2)(c) as not including "latent defect" because the defect is not a "quality" known to the buyer, there is no inconsistency between the Code and the Convention. On the other hand, if a court considers the meaning of "qualities" to be "the sample as it is," the seller will not be liable for the latent defect in the goods. An inconsistency arises between the Code and the Convention in the latter situation. In case of inconsistency, Article 35(2)(c) of the Convention prevails.

## E. DELIVERY

Delivery is one of the important aspects of contract of sale. Chinese law did not formulate specific rules on delivery until March 1999 when the Code was promulgated. Delivery is relevant to the passing of property and risk between the seller and the buyer, but it is also relevant for determining the performance of the parties. Inspection of the goods delivered and notice of the defect in the goods are also regulated in the rules of delivery. Similar rules governing delivery under the Code and the Convention are set out as follows: (1) both state that the seller should deliver the goods to the buyer on the agreed date or within the agreed period of time;[140] (2) both require the seller to deliver the goods at the agreed place of delivery;[141] in the absence of the agreed place of delivery, both adopt the same criteria for determining the place of delivery;[142] (3) both require the buyer to examine the goods received in pursuance of the relevant agreement, or within a reasonable period of time as the case may be;[143] (4) both take the position that the buyer loses the right to rely on a lack of confor-

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139. Vienna Sales Convention, *supra* note 1, art. 35(2)(c).

140. *Compare* C. CONT. L., *supra* note 2, art. 138, *with* Vienna Sales Convention, *supra* note 1, arts. 33(1), 33(2).

141. *Compare* C. CONT. L., *supra* note 2, art. 141, *with* Vienna Sales Convention, *supra* note 1, art. 34.

142. *See* C. CONT. L., *supra* note 2, art. 141; *see also* Vienna Sales Convention, *supra* note 1, art. 31 (explaining that the place of delivery can be the place where the goods are delivered to the first carrier; the place of the goods known to the parties at the conclusion of the contract; or the place where the seller has his or her business at the time of the conclusion of the contract).

143. *Compare* C. CONT. L., *supra* note 2, art. 157, *with* Vienna Sales Convention, *supra* note 1, art. 38.

mity if he or she does not inform the seller of the non-conformity within a reasonable time[144] and both adopt a two year limitation period for the buyer to notify the seller of the non-conformity of the goods received;[145] (5) both take the position that the buyer has an option to decide whether to accept the part of delivery exceeding the agreed quantity;[146] and (6) both adopt identical rules for dealing with installment delivery, including termination of the contract relating to a particular installment and termination of the whole contract for a certain breach in one of the installments.[147]

It does not appear that any significant difference between the Code and Convention in relation to delivery exists. Actually, the rules of delivery set forth in the Code are largely identical to the relevant provisions of the Convention, except for the rules affecting the passing of risk discussed earlier. The similarities discussed suggest that this part of the Code was modeled on the relevant provisions of the Convention.

## F. PAYMENT OF PRICE

Payment of price is the major obligation of the buyer and the major concern of the seller. Generally speaking, in an international sale, the seller intends to control the goods to secure the payment against the goods and the buyer intends to control the payment to ensure that goods conform to the terms of contract. Accordingly, a contract of sale often contains a clause permitting the unpaid seller to have a lien in the goods sold until full payment is made. The issue of payment is regulated in the Vienna Sales Convention, the sale of goods law in common law jurisdictions, and also in the Code. The similar rules of the Code and Convention are set out as follows: (1) both state that

144. *Compare* C. CONT. L., *supra* note 2, art. 158, *with* Vienna Sales Convention, *supra* note 1, art. 39(1).

145. *Compare* C. CONT. L., *supra* note 2, art. 158, *with* Vienna Sales Convention, *supra* note 1, art. 39(2).

146. *Compare* C. CONT. L., *supra* note 2, art. 162, *with* Vienna Sales Convention, *supra* note 1, art. 52(2) (implying that if the buyer accepts the excess of the goods delivered, he or she needs to pay for the goods according to the contract price).

147. *Compare* C. CONT. L., *supra* note 2, art. 166, *with* Vienna Sales Convention, *supra* note 1, art. 73.

the buyer is obligated to pay the price of contract as agreed[148] and both require, directly or indirectly, that the buyer make payment according to the agreed time;[149] (2) in the absence of agreement on the time of payment, both state that the buyer should pay the price at the time of receiving the goods or the document of title concerning the goods;[150] and (3) both adopt the identical words in stating that in the absence of agreement on the place of payment, the place of payment should be the seller's place of business or the place where the goods or the relevant document of title is to be handed over to the buyer.[151]

On the other hand, the Code adopts a number of rules relating to the payment of price, which are dissimilar to the Convention. The major differences between the Code and the Convention are identified as follows: (1) in the absence of agreement on the price, the Code requires the parties to fix the price by a subsequent agreement, or according to the relevant contractual terms, the relevant trading usage, the market price of the goods at the place of performance, or the relevant directives or guidance of the government as the case may be;[152] by comparison, the Convention requires, the price to be determined by reference to the market price of the goods at the time of the conclusion of the contract, unless the parties agree otherwise.[153] In the absence of agreement on the time or the place of payment, besides the similarities referred to above, the Code actually requires the parties to fix a time or place by negotiation or permits the court to fix the time or place according to the terms of contract or the relevant commercial usage;[154] and (2) the Code specifically states that if the buyer fails to pay the installment due, amounting to a fifth of

148. *Compare* C. CONT. L., *supra* note 2, art. 159, *with* Vienna Sales Convention, *supra* note 1, arts. 53, 54.

149. *See* C. CONT. L., *supra* note 2, art. 161; *see also* Vienna Sales Convention, *supra* note 1, arts. 53, 54.

150. *See* C. CONT. L., *supra* note 2, art. 161; *see also* Vienna Sales Convention, *supra* note 1, art. 58(1).

151. *See* C. CONT. L., *supra* note 2, art. 160; *see also* Vienna Sales Convention, *supra* note 1, art. 57.

152. *See* C. CONT. L., *supra* note 2, arts. 61, 62, 159.

153. *See* Vienna Sales Convention, *supra* note 1, art. 55.

154. *See* C. CONT. L., *supra* note 2, arts. 61, 161.

the total price of the contract, the seller may either demand the payment of the full price or terminate the contract of sale,[155] and there is no compatible provision in the Convention.

The aforesaid differences may or may not lead to conflicts or inconsistencies between the Code and the Convention, depending on the interpretation of the Convention. The Code provides additional rules for the determination of the sum, place, or time of payment. If the relevant provisions of the Convention are regarded as exhaustive or exclusive, there is no scope for the operation of the aforesaid rules of the Code. Otherwise, the aforesaid rules of the Code may be regarded as supplementary to the provisions of the Convention. In addition, the payment of price in an installment contract is not regulated in the Convention specifically. Arguably, the Code supplements the Convention in this regard. It is more likely that there is no direct or indirect conflict between Article 167 of the Code and the Convention. Of course, this statement is subject to a reasonable and narrow interpretation of the provisions of the Convention.

## V. REMEDIES FOR BREACH OF CONTRACT UNDER THE CODE OF CONTRACT LAW

### A. GENERAL OVERVIEW

Generally speaking, the concept of remedy refers to various rights, techniques, methods, measures, and compensations to which the innocent party may resort for the purpose of preventing or reducing the damage incurred to compensate for losses sustained or to protect a party's right recognized in law, when the other party breaches the contract. For example, the right to ask the breaching party to perform certain obligations, the right to terminate a contract because of the other parties breach, and the right to seek compensation against the breaching party are common forms of remedies provided in law.

The issue of remedies is regulated in Articles 68, 69, 77, 91 through 122, and 128 of the Code, spreading over five chapters.[156] The Code appears to adopt approaches different from the common

155. *See id.* art. 167.

156. *See generally* C. CONT. L., *supra* note 2, arts. 68, 69, 77, 91-122, 128 (setting forth the remedies offered under Chinese law for termination of contracts).

law tradition to the categorization of remedies. For example, suspension of performance may be regarded as a remedy in a common law jurisdiction, but regulated as an issue of performance in the Code. Similarly, change of contract by agreement may be regarded as a remedy in a common law jurisdiction, but is treated as an issue relating to the change or transfer of contract under the Code. On the other hand, settlement of a dispute by negotiation or mediation is always a unique feature of Chinese law regulating commercial transactions, but is not always expressly referred to as a remedy in a common law jurisdiction. For convenience of discussion, remedies under the Code will be discussed in four categories: suspension of a contract, termination of a contract, damages, and specific performance.

## B. SUSPENSION OF CONTRACT

Suspension of contract performance is a temporary measure to relieve an innocent party from performing his or her obligations under a contract. It is different from rescission or termination of a contract because the performance may be reassumed if the situation justifying the suspension ceases to exist, or if the condition stipulated in law for reassuming the performance occurs. It is also different from the termination or rescission of a contract in the sense that it is often based either on the evidence that suggests the probability of a future breach, or it is used to prevent damages likely to be caused by a party's future breach. The right of suspension is fair to the innocent party if the other party shows some evidence of his or her inability to perform the obligations in the future.

The Code permits the party who is obligated to perform under the contract ahead of the other party's right to suspend his or her own performance if the other party appears to be unable to perform his or her obligation under the contract.[157] This rule of the Code reflects continental law tradition, in the sense that it assumes the existence of an order of priority between the parties' obligations to perform a contract, implying the existence of an obligation and a right in the order of performance. It appears that the right to suspend a contract is a right to be exercised by the party who is obliged to perform cer-

157. *See* C. CONT. L., *supra* note 2, art. 68.

tain contractual obligations before the performance of the other party. In this sense, the rule of anticipatory breach in a common law jurisdiction may be similar to the said rule of suspension in Chinese law. Article 68 of the Code permits an obligor to suspend performance of his or her obligation in one of the following situations: (1) the other party's state of business has seriously deteriorated; (2) the other party has transferred or moved his or her property or money for the purpose of avoiding his or her obligations and debts; (3) the other party has lost his or her business reputation; or (4) there is any other possibility of the other party losing or likely to lose the ability to perform his or her obligation.

Ultimately, the party intending to exercise the right of suspension is obliged to provide evidence. Otherwise, the party suspending the performance is liable to the other party for breach of contract. If a party intends to exercise the right of suspension under Article 68 of the Code, he or she must inform the other party of the decision promptly.[158] If the other party provides adequate security for performance, the party suspending performance should reassume his or her performance. The suspension is a transitional stage for the party suspending performance to rescind the contract. Under Article 69 of the Code, if the other party is unable to regain the ability to perform and also fails to provide an adequate security for performance, the party suspending performance is entitled to avoid the contract concerned. It appears, however, that Article 69 does not permit a party to avoid a contract if the other party provides an adequate security, whether or not the latter shows an ability to perform.[159]

Article 71 of the Convention deals with anticipatory breach, which is similar to what is regulated by Articles 68 and 69 of the Code. For example, Article 71 of the Convention permits a party to suspend performance when there is a serious deficiency in the other party's ability to perform or in his or her credit-worthiness;[160] or when there is an inconsistency between the other party's conduct in preparing to perform or in performing the contract.[161] It appears that the provisions

158. *See id.* art. 68.

159. *See id.* art. 69.

160. *See* Vienna Sales Convention, *supra* note 1, art. 71(1)(a).

161. *See id.*

of the Convention are much broader than the relevant provisions of the Code regarding the grounds for suspension. Although more specific grounds are given in the Code, the wording of the relevant provisions of the Code and Convention suggest that both laws cover the same situations and thus are consistent because of the flexibility of the wording.[162] Similarly, both the Code and the Convention require the party suspending performance reassume the performance after the other party provides an adequate assurance or security for the latter's performance.[163]

In terms of the act of suspension, the Convention is more specific than the Code. The Convention vests the seller with a right to stop delivery of goods to a buyer holding the document of title over the goods on the ground that the cause for suspension will become evident soon.[164] A seller, however, may adopt the same measure under the Code under a belief that one of the stipulated grounds for suspension exists, because he or she will be eventually liable to the buyer if the belief turns out to be groundless. The Convention does not have a specific rule on wrongful suspension of performance by a party. However, a party suspending the performance of his or her obligations wrongfully will be held liable under Article 74 of the Convention if his or her act caused damages to the other party's interests.[165]

### C. TERMINATION OF CONTRACT

Termination of contract is one of the basic remedies in contract law. The rights and obligations of the contracting parties under the contract, which are reciprocal and correspondent, cease to exist after the termination. If one party breaches the essential terms of a contract, or fails or is unable to perform his or her essential obligations, it would be unfair to compel the innocent part to perform unilaterally his or her obligations under the contract. Accordingly, termination of the contract is one of the options to ensure fairness in commercial

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162. *Compare* C. CONT. L., *supra* note 2, arts. 68, 69, *with* Vienna Sales Convention, supra note 1, art. 71.

163. *See* C. CONT. L., *supra* note 2, art. 69; *see also* Vienna Sales Convention, *supra* note 1, art. 71.

164. *See* Vienna Sales Convention, *supra* note 1, art. 71.

165. *See id.* art. 74.

relationships. Sometimes, a contract cannot be realistically performed as the parties intended because of some reason beyond their control. Termination of the contract appears to be the only fair and reasonable solution to relieve the parties from their obligations to each other. This is also necessary to ensure the stability of commercial relationships and the dignity of the law governing contracts.

Article 94 of the Code states that a party is entitled to terminate a contract in one of the following situations: (1) where the purpose of the contact cannot be realized due to *force majeure*;[166] (2) before the expiration of the time for performance, a party states expressly or by conduct an intention not to perform his or her major obligations;[167] (3) where a party not only failed to perform his or her major obligations within the agreed time, but also refused to perform within a reasonable time after the other party's notice to urge the performance;[168] (4) the purpose of the contract cannot be realized due to a party's delay in performing his or her obligations or other breaching act;[169] or (5) any other situations stipulated in law.[170] The Code regards the right to terminate a contract as a "right." Article 93 of the Code actually uses the expression "holder of the right of termination."[171] Such treatment of termination reflects one of the underlying notions, if not the underlying notion of the Code, that is: a contract is largely based on the dichotomy of the right and obligation, namely a contract is by nature an obligation.

The first ground for the termination of a contract, *force majeure*, is commonly accepted across the world. Usually it refers to any natural cause, any reason beyond the control of the contracting parties or any reason for which neither contracting party is liable. Under the Code, however, the change of the party's name or title, or any personnel change involving the appointment or resignation of the legal representative, director, or responsible person of a contracting party does not constitute *force majeure* and thus does not affect the party's obli-

166. *See* C. CONT. L., *supra* note 2, art. 94(1)(a).

167. *See id.* art. 94(1)(b).

168. *See id.* art. 94(1)(c).

169. *See id.* art. 94(1)(d).

170. *See id.* art. 94(1)(e).

171. *See* C. CONT. L., *supra* note 2, art. 93.

gations under the contract concerned.[172] The foregoing provision is inserted into the Code largely because of the malpractice of many Chinese companies, in particular those owned by the State or the collectives, and the companies' attempts to avoid their contractual obligations on the ground that their managerial structure or their identity has changed.

The Code appears to adopt something similar to what is known as fundamental breach under the Convention,[173] or breach of fundamental terms in the common law tradition. The second and third grounds set forth in Article 94 are relevant to breach of major obligations.[174] As previously discussed, the second ground allows a party to terminate a contract on the ground that the other party presented an intention to refuse to perform the latter's major obligations. The relevant words in Chinese may also be translated as main obligations, principal obligations, or more arguably as fundamental obligations. The third ground uses the same expression of major obligations and allows a party to terminate a contract if the other fails to perform his or her major obligations even after the former gives an extension for performance by urging the latter to perform. The meaning of "major obligations" is unclear, but can be assumed to be similar to fundamental breach or breach of fundamental terms. Different judicial interpretations, however, are expected to develop for these concepts. The concept of major obligations implies that a party cannot terminate a contract on the second or third ground if the other party did not breach or did not refuse to perform any major obligation.

The differences between the aforesaid second ground and third ground are not clear in Article 94. The second ground permits a party to terminate a contract if the other party shows an intention not to perform his or her major obligations by conduct.[175] The third ground, however, appears to request a party to give a warning or a notice to urge the other party[176] who failed to perform his or her obligation

172. *See id.* art. 76.

173. *See* Vienna Sales Convention, *supra* note 1, art. 73.

174. *See* C. CONT. L., *supra* note 2, art. 94.

175. *See id.* art. 94(2).

176. *See id.* art. 94(3).

within the time stipulated by the contract to perform before the former can terminate a contract. In this regard, the second and third grounds are inconsistent. Specifically, the second ground appears to suggest that non-performance itself is an indication of a party's intention to breach his or her major obligations, but non-performance within the stipulated time for performance is insufficient for a party to terminate a contract on the third ground. If such interpretation is correct, who would rely on the third ground for termination?

There are two possible reasons for the co-existence of the second and third grounds. First, a party's non-performance within the stipulated time may not be an indication of an intention to breach his or her major obligations. Second, the third ground is intended to have the same functions as Articles 47, 49, 63, and 64 of the Convention to encourage the use of a grace period to facilitate the performance of a contract. However, the first reason may be challenged on the ground that if the delay in performing a party's major obligations is not caused by the party's fault, the party is not liable. Why should the party be penalized later in an additional period for performance by giving the other party a right to terminate the contract, while the first party is probably entitled to declare a contract avoided on the ground of *force majeure*. In addition, it is also arguable that certain non-performance without justification always constitutes a breach of major obligations.

The fourth ground for termination of a contract under Article 94 does not refer to major obligations,[177] rather it emphasizes whether or not a party's breach of contract makes the realization of the goal of the contract impossible. Is this ground closer to the meaning of fundamental breach under the Convention and breach of fundamental terms under the common law tradition than the aforesaid grounds referring to major obligations? The answer lies in the hands of the court because all of the grounds are capable of covering the same issues covered by the concept of fundamental breach or breach of fundamental terms. It appears that all of the grounds are supplementary to each other, providing grounds for the termination of contract whenever it is necessary and justified.

The third ground for termination of a contract under Article 94 ap-

177. *See id.* art. 94(4).

pears similar to what is known as the grace period set out in Articles 47 and 63 of the Convention and the right to terminate a contract at the end of a grace period as set out in Articles 49(1)(b) and 64(1)(b) of the Convention.[178] Articles 47 and 49 of the Convention apply to the buyer and Articles 63 and 64 of the Convention apply to the seller.[179] The rights and obligations of the buyer and the seller are parallel to each other. The Convention is explicit in stating that the buyer or the seller has an option to give an additional period for the seller or the buyer, as the case may be, to perform.[180] The provision reflects one of the fundamental principles of the Convention, namely to encourage the parties to perform their contract to the greatest extent possible to avoid and reduce the scope of dispute between them. Technically, if a buyer or a seller chooses to give a grace period to the seller or the buyer under Articles 47 or 63, the buyer or the seller may later rely on Articles 49(1)(b) or 64(1)(b) of the Convention to terminate the contract.[181] In relying on Article 49(1)(b) or 64(1)(b), the party can avoid the technical difficulties of terminating a contract under other provisions of Article 49.[182] For example, in complying with Articles 47 and 49(1)(b), the buyer avoids the difficulty of establishing the existence of a fundamental breach under Article 49(1)(a) against the seller.[183] Similarly, in complying with Articles 63 and 64(1)(b), the seller avoids the difficulty of establishing the existence of fundamental breach under Article 64(1)(a) against the buyer.[184]

Under the Convention, termination of a contract is a remedy available for both the seller and the buyer. Different grounds for terminating a contract are provided to the seller and the buyer respectively. Under Article 49 of the Convention, the buyer may terminate

178. *See* Vienna Sales Convention, *supra* note 1, arts. 47, 49(1)(b), 63, 64(1)(b) (establishing the rights of the parties to terminate the contract).

179. *See id.* arts. 47, 49, 63, 64.

180. *See id.* art. 46.

181. *See id.* arts. 47, 49(1)(b), 63, and 64(1)(b).

182. *See id.* art. 49.

183. *See generally* Vienna Sales Convention, *supra* note 1, arts. 47 and 49(1)(b).

184. *See generally id.* arts. 63 and 64(1)(b).

a contract on one of the following grounds:[185] fundamental breach of the seller; non-performance in the additional period for performance; late delivery (available only if the buyer takes a legal action within a reasonable time after he or she is aware of it); and any other grounds which justify the termination of the contract. It appears from the foregoing that the Convention draws from a group of mixed principles for granting the right to terminate a contract. On the one hand, there is the principle or doctrine of fundamental breach. On the other hand, a contract may be terminated if the seller fails or refuses to perform his or her obligation within the grace period, or the conditions for terminating a contract as set forth in Article 49 are met.

The seller's right to terminate a contract is regulated in Article 64 of the Code, which sets out the following grounds for a seller's termination of contract:[186] fundamental breach; non-performance within the grace period; late performance (only when the seller does not know that performance has been rendered); or any other breach, which gives rise to a right to terminate a contract, but the right must be exercised within a reasonable period of time after the seller knows or ought to have known of the breach.

Article 64 of the Convention also draws from a combination of principles, including fundamental breach, non-performance within the grace period and other serious breaches justifying the termination of a contract. It is not clear what the essential difference is between a fundamental breach and a breach that gives rise to the right to terminate a contract. In this regard, both the Convention and the Code provide ambiguous guidelines for ascertaining a fundamental breach from a general breach warranting a termination, or a breach of major obligations from a general breach warranting a termination.

The Convention contains specific provisions for terminating part of or the whole of an installment contract.[187] Under these provisions, depending on the circumstances, the innocent party may declare a contract: (1) voided with respect to a particular installment; (2) voided for future performance; or (3) a buyer may declare the whole

185. *See id.* art. 49.

186. *See id.* art. 64.

187. *See id.* art. 73.

contract voided.[188] The termination of an installment contract is not found in the general provisions regulating the termination of contract in the Code. Instead, the provisions compatible to Article 73 of the Convention are found in Article 166 of the Code. Article 166 of the Code provides that if the purpose or object of the contract cannot be fulfilled due to a breach in any installment, the buyer may terminate the relevant part of the contract, the future part of the contract, or the whole contract, including the part already performed.[189] It appears that Article 166 of the Code is modeled on Article 73 of the Convention.[190] The expression "fundamental breach," which is used as the basis for terminating an installment contract under Article 73 of the Convention, means the purpose or object of the contract cannot be fulfilled or realized, which is the prerequisite for the buyer to terminate an installment contract under Article 166 of the Code.[191]

### D. DAMAGES

Damages are one of the feasible ways recognized by law to compensate an innocent party's loss sustained as a result of a breaching party's act. Damages should reflect a fair assessment of the loss sustained by the innocent party. Sometimes, a reasonable sum of penalty against the breaching party may arguably be implied in the sum of damages granted. Although a common law court may be reluctant to grant punitive damages in a contractual dispute,[192] Article 114 of the Code expressly permits the court or an arbitration tribunal to fix the sum of a fine or penalty according to the method of calculation agreed by the parties in a contract.[193] In Article 114, the term damages is used in a broad sense, covering all forms of monetary compensations a court may grant to the innocent party under the Code and the Convention.

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188. *See id.* art. 73(1).

189. *See* C. CONT. L., *supra* note 2, art. 166.

190. *Compare id.*, *with* Vienna Sales Convention, *supra* note 1, art. 64.

191. *See* C. CONT. L., *supra* note 2, art. 166.

192. *See* G.H. TREITEL, THE LAW OF CONTRACT 845 (Sweet & Maxwell eds.) (9th ed. 1995).

193. *See* C. CONT. L., *supra* note 2, art. 114.

The major provisions of the Code regulating damages are Articles 107, and 112 through 116. Article 107 of the Code states that the breaching party is obligated to remedy his or her breach by remedial acts or by compensation.[194] Article 112 of the Code acknowledges the right of an innocent party to seek damages if the remedial act of the breaching party does not cure or remedy all the losses sustained by the innocent party.[195] Article 112 of the Code is compatible with Articles 45(2) and 61(2) of the Convention.[196] Article 113 states that the sum of compensation should be equivalent to the loss caused by the breach. This includes the expected profit gain if the contract is performed. Compensation, however, cannot exceed the sum of loss foreseen or foreseeable by the breaching party at the time of the conclusion of the contract.[197] This provision is largely identical to Article 74 of the Convention, suggesting that Article 74 of the Convention strongly influenced Article 113 of the Code.[198]

Article 114 of the Code regulates the use of a fine or penalty in a contract. Under this provision, parties may agree upon the sum of a fine or penalty in case of a breach by any party, or the method for calculating the fine or penalty.[199] If the fine or penalty fixed in a contract is lower or excessively higher than the actual loss, a party may ask the court or the relevant arbitration authority to increase or decrease the sum accordingly.[200] If a fine or penalty is imposed for late performance, the payment of the fine or penalty does not relieve the obligor from the duty to perform the obligation.[201] In the light of Article 114, it appears that a fine or penalty is relevant to the actual loss caused by the breaching act concerned. In practice, the application of Article 114 may be problematic. In case of late performance, the loss is restricted to the loss caused by the late performance. By compari-

194. *See id.* art. 107.

195. *See id.* art. 112.

196. *Compare id.* art. 112, *with* Vienna Sales Convention, *supra* note 1, arts. 45(2), 61(2).

197. *See* C. CONT. L., *supra* note 2, art. 113.

198. *Compare id.*, *with* Vienna Sales Convention, *supra* note 1, art. 74.

199. *See* C. CONT. L., *supra* note 2, art. 114.

200. *See id.*

201. *See id.*

son, in the case of terminating a contract due to non-performance, the loss includes the loss caused by the termination of the contract. If the loss is assessed in this way it is unclear what the difference is between a fine and penalty under Article 114 and damages under Article 113. It appears that a clarification of Article 114 by the court in appropriate time will be necessary because the Convention does not have an equivalent provision concerning the use of fine or penalty in a contract.

Article 115 of the Code regulates the use of deposit.[202] This provision states that the parties may in pursuance of the Law of Guarantee of the PRC agree on the payment of a deposit as guarantee. If the party paying the deposit has performed his or her obligation, the deposit may be converted to the payment of price or be returned to him or her.[203] If the party paying the deposit fails to perform his or her obligation, he or she is not entitled to demand the return of the deposit. On the other hand, if the party taking the deposit fails to perform his or her obligation, he or she must pay the party paying the deposit a sum equal to two times of the sum of the deposit.[204] The punitive nature of such deposit is clear. There is no compatible provision in the Convention for the use of deposit.

It appears that both a fine and a deposit may not be applied in the same contract. Article 116 of Code provides that if parties incorporate both fine and deposit clauses in a contract, the innocent party may choose one of the clauses, suggesting that the two forms of punitive remedies are not available in the same contract.[205] Generally speaking, the provisions of the Code concerning damages represent a strong tendency to provide remedies penalizing the breaching party; and by comparison, the provisions of the Convention emphasize compensation for the loss sustained by the innocent party.

Mitigation of loss is an important aspect of damages. The innocent party is obligated to mitigate losses incurred and to prevent to the greatest extent possible aggravation of losses. This is rational and sound in economics, as well as sensible and fair to the party breach-

202. *See id.* art. 115.

203. *See id.*

204. *See* C. CONT. L., *supra* note 2, art. 115.

205. *See id.* art. 116.

ing a contract. Both the Code and the Convention require the parties to mitigate losses whenever possible. Article 119 of the Code provides that the innocent party should adopt adequate measures to prevent the aggravation of the loss caused by the breaching party.[206] If the innocent party fails to mitigate the loss concerned, he or she is not entitled to claim damages for the aggravated damage caused by his or her failure. The cost for mitigating losses is ultimately borne by the breaching party. A similar position is taken by Article 77 of the Convention.[207] Although the wordings of these provisions are different, they appear to be capable of reaching the same result under similar circumstances.

## E. SPECIFIC PERFORMANCE

Specific performance means that the court directs a party to perform a specific act in pursuance of the contract concerned. It appears tough on the breaching party in certain circumstances where the party may be willing to pay damages rather than to perform the contract. On the other hand, it appears to be fair and just to the innocent party whose loss cannot be assessed adequately by financial compensation or cannot be compensated by damages at all. Determination of whether a particular situation justifies the grant of specific performance is totally subject to the discretion of the court. This may lead to unpredictability in the decisions of the court and is probably one of the reasons common law courts are reluctant to grant specific performance.

Articles 109 through 111 of the Code regulate specific performance. Article 110 is the principal provision regulating specific performance, and Articles 109 and 111 supplement Article 110. It appears that the Code adopts a generous attitude to the use of specific performance. Article 110 states that if a party does not perform his or her obligation, which is not a financial obligation, or if the party has not performed the obligation according to the contract, the other party may request the former to perform the obligation concerned, unless one of the following situations arise:[208] performance is impos-

206. *See id.* art. 119.

207. *See* Vienna Sales Convention, *supra* note 1, art. 77.

208. *See* C. CONT. L., *supra* note 2, art. 110.

sible in law or in practice;[209] the subject of the obligation is not suitable for performance or the cost of performance is too high; [210] or the obligee does not request performance within a reasonable time.[211] This provision suggests that specific performance is generally available unless the obligor establishes that one of the situations prescribed in Article 110 exists. Article 110 supports either a request of the innocent party made directly to the breaching party or an action of the innocent party to request the court to order specific performance against the breaching party. [212]

Article 110 of the Code does not cover all situations where specific performance can adequately remedy the loss of the innocent party. For example, the buyer's failure to pay the price of contract is not covered by Article 110. Thus, Article 109 provides that if a party did not pay money or other rewards in compliance with the contract, the other party may request the former to do so.[213] Of course, if the breaching party refuses to comply with the innocent party's request, the court will force him or her to pay to the innocent party under Article 109. Article 111 of the Code deals with a different type of specific performance.[214] This provision states that in the absence of agreement on quality, the innocent party may choose to request the breaching party to repair, substitute, or remake the subject (including goods) which does not conform with the contract, or return the non-conforming subject to the breaching party, or the innocent party may reduce the price or reward for the non-conforming subject.[215] Article 111 applies to all types of contracts, such as service or processing contract; therefore, the subject concerned may not necessarily be the goods. This type of specific performance is different from the specific performance under Article 110 in the sense that the specific performance under Article 111 largely involves an act to make the non-conforming goods conform by employing various feasible means. In

209. *See id.* art. 110(1).

210. *See id.* art. 110(2).

211. *See id.* art. 110(3).

212. *See id.* art. 110.

213. *See* C. CONT. L., *supra* note 2, art. 109.

214. *See id.* art. 111.

215. *See id.*

addition, Article 111 applies only to disputes on quality that are not stipulated by the contract or fixed by the agreement of the parties, the terms of contract or the relevant commercial usage. Thus, the right of the innocent party to seek specific performance under Article 111 depends on the nature of the subject or the goods involved and the extent of damage to them.

Specific performance is not expressly provided for in the Convention, but it is one of the remedies available to either the seller or the buyer in case of the other's breach. Certain provisions of the Convention appear to permit the parties to request each other to perform a specific act as one of the self-remedies. For example, Article 46(1) of the Convention states that the buyer can require the seller to perform his obligations unless the buyer resorts to a remedy consistent with this requirement.[216] Similarly, Article 46(2) states that if "the goods do not conform with the contract, the buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach of contract and a request for substitute goods is made either in conjunction with notice given under Article 39 or within a reasonable time thereafter."[217]

Whether a buyer should rely on the foregoing provisions to ask the court to order the seller to perform a specific act is unclear because most provisions of the Convention are meant to encourage the parties to resolve their disputes themselves. If a buyer can rely on the said provisions to ask the court to order the seller to perform the act concerned, these provisions can be regarded as provisions on specific performance. Similarly, the corresponding provisions giving the seller a right to request the buyer to perform a specific act, such as Articles 62 and 63, may also be regarded as provisions on specific performance. If the said self-remedial provisions can also be enforced by a court, the Code and the Convention would be largely consistent with each other in relation to the regulation of specific performance, except that there is no express rule in the Convention on the circumstances where specific performance is not available. In a sense, such an express rule is unnecessary because the so-called specific performance may only be enforced in the specified circum-

216. *See* Vienna Sales Convention, *supra* note 1, art. 46(1).

217. *Id.* art. 46(2).

stances and under specific conditions. Even if both the Code and the Convention have recognized the use of specific performance, they have adopted different approaches to the regulation of the specific performance. The Code starts from a general application of specific performance as a remedy, while the Convention starts from a specific application of specific performance as a remedy.

## VI. MAJOR FEATURES OF THE CODE OF CONTRACT LAW

### A. FUSION OF CONTRACT LAWS

A foreign party to a contract in China is an issue of Chinese law warranting discussions. It is Chinese practice, since 1949, for different laws to exist for domestic and foreign related matters in most social and economic relationships. For example, the well-known Chinese arbitration institution, the China International Economic and Trade Arbitration Commission ("CIETAC"), was initially set up as a special agency handling only foreign related arbitration. The National Supreme Court adopted the practice of issuing special opinions or directives to deal with foreign related legal issues.[218]

In the area of foreign investment law, many parallel laws and regulations co-exist with foreign related laws only applying to the issues involving foreign elements. In certain areas of the economy where foreign elements are not significant, however, the uniform laws apply to both foreign and local interests, i.e., the Trademark Law[219] of 1982 and the Patent Law[220] of 1984. From the 1990s, a significant fusion existed between the special laws for foreign related matters and the special laws for domestic matters. The Companies

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218. *See* John Mo, *The Company Law and Foreign Investment Law*, 2 CHINA LAW UPDATE 3, 4-6 (1999) (presenting examples that during the 1950s, the National Supreme Court issued about 20 separate opinions or directives concerning foreign related marriage, including the marriage between local Chinese and overseas Chinese).

219. *See* The People's Republic of China-United States: Agreement Regarding Intellectual Property Rights, *available in* 34 I.L.M. 881, 896 (1995).

220. *See* The People's Republic of China: Patent Law, *available in* 24 I.L.M. 295 (1985).

Law[221] passed in 1993 and the Arbitration Law[222] passed in 1994 are two such examples. The Companies Law does not entirely supersede the operation of the foreign investment laws, such as the Joint Equity Ventures Law,[223] the Joint Cooperative Ventures Law,[224] and the Sole Foreign Investment Enterprises Law,[225] making most foreign investment enterprises subject to a kind of double jurisdiction under these foreign investment laws and the Companies Law.[226] The Arbitration Law by comparison abolished the physical separation between foreign related arbitration and domestic arbitration, although different rules apply to the process of foreign related arbitration. The Code of Contract Law made significant progress in China's legal reform in the sense that it formally abolished the separation between the Economic Contract Law (applying to domestic contracts) and the Foreign Economic Contract Law (applying to foreign related contracts).

Under the Code of Contract Law, a foreign party receives neither special favor nor discriminatory treatment. The rules do not change because of the nationality or identity of the party concerned, except perhaps where procedural issues are involved. A foreign party is treated in the same way as a Chinese party. In this regard, the Code has adopted the principle of national treatment to all foreign persons and companies entering into contractual relationships under the Code and is consistent with the national treatment principle of the World Trade Organization ("WTO").

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221. *See* Mo, *supra* note 218, at 4-6 (discussing generally the tenets of the Chinese Companies Law implemented in 1993).

222. *See* The People's Republic of China: Arbitration Law, *available in* 34 I.L.M. 1650 (1995).

223. *See* The Law of the People's Public of China on Sino-foreign Joint Equity Ventures, *reprinted in* China L. Foreign Bus. (CCH Austl.) P 6-500 (1979).

224. *See id.*

225. *See* Zhonghua Renmin Gongheguo Waizi Qiye Fa [The Law of the People's Republic of China Concerning Enterprises with Sole Foreign Investment] (adopted Apr. 12, 1986), *translated in* [2 Bus. Reg.] China L. for Foreign Bus. (CCH Int'l) P13-506(6) (1991).

226. *See* Mo, *supra* note 218, at 4-6 (discussing generally the tenets of the Chinese Companies Law implemented in 1993 and certain issues arising from such double jurisdiction).

### B. UNCERTAINTIES AFFECTING A FOREIGN PARTY

While the Code does not differentiate between a foreign party and a local party, a foreign investor in China is still subject to the Joint Equity Ventures Law, the Joint Cooperative Ventures Law and the Sole Foreign Investment Enterprises Law, which form the legal basis of various foreign investments in China. Contract law is the foundation of all forms of foreign investment. Whether a foreign investor utilizing any of the three forms of foreign investment vehicles is subject to the double jurisdiction of the Code and the relevant foreign investment law remains unanswered.

As previously mentioned, the Code supersedes the Foreign Economic Contract Law that was formerly applicable to most contracts made between foreign parties and a Chinese party.[227] Although Article 2 of the Foreign Economic Contract Law appears to state that the Law applies to a contract between a Chinese party and a foreign party only, a contract made in China between two foreign parties before October 1, 1999[228] is arguably subject to the Law. Generally speaking, the Code is much more detailed than the Foreign Economic Contract Law, and thus provides better protection to foreign companies and residents.[229] It must be emphasized that due to the differences between the Foreign Economic Contract Law and the Code, and the fact that the Code commenced operation October 1, 1999, foreign companies and businesspersons that made contracts with

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227. *See* 23 SELECTED CASES OF THE PEOPLE'S COURT 131-40 (Institute for Practical Legal Research of the National Supreme Court ed.) (Publishing House of the People's Court 1998) (in Chinese) (providing a synopsis of *Yonglong Machinery Company v. Lida Construction Company and Others*). In *Yonglong Machinery Company*, the plaintiff was a buyer of a hydraulic excavator manufactured by a Korean company, which was joined as one of the co-defendants of the case. *See id.* The excavator was defective and the Korean company was unable to provide the maintenance services promised to the first defendant that sold the machine to the plaintiff in 1995. *See id.* The court held that the Foreign Economic Contract Law applied to the case and ordered the defendants to repair the excavator and to compensate the plaintiff for its loss caused by the defective excavator. *See id.*

228. *See* FOREIGN ECON. CONT. L., *supra* note 5, at 797.

229. *Compare* C. CONT. L., *supra* note 2, arts. 69-76 (addressing the performance of contract), *with* FOREIGN ECON. CONTR. L., *supra* note 5, arts. 16-25 (same).

their Chinese counterparts need to consider the different effects of the different sets of law to their transactions. Depending on the nature of transaction, they may be able to choose whether the Foreign Economic Contract Law applies or the Code applies. All businesspersons should make an effort to ensure that the transactions comply with the Code if the transaction continues beyond October 1, 1999, to avoid complexities and uncertainties in the future.

It is worth noting that the investment activities such as joint equity ventures, joint cooperative ventures, and sole foreign investment enterprises may or may not be subject to the Code of Contract Law, depending on the circumstances involved. The fifteen types of specific contracts set out in the Code do not expressly include investment contracts of any kind.[230] Article 428 of the Code of Contract Law only expressly repeals the Economic Contract Law, the Foreign Economic Contract Law, and the Technology Contract Law from October 1, 1999 forward.[231] In past experiences, some of the joint cooperative venture and joint equity venture contracts were subject to the Foreign Economic Contract Law,[232] while others were not.[233] Logi-

230. *See generally* C. CONT. L., *supra* note 2, arts. 130-427 (setting forth fifteen specific contracts that are addressed by the Code).

231. *See id.* art. 428.

232. *See* SELECTED CASES OF THE PEOPLE'S COURT 120-24 (Institute for Practical Legal Research of the National Supreme Court ed.) (Publishing House of the People's Court 1995) (in Chinese) (providing a summary of *Keiwei Company of United States v. City Construction and Development Company of Changchun*, where the parties were negotiating a contract to establish a joint venture in Changchun to develop an entertainment park in 1992). The Chinese party wished to visit the American party's business operation to decide whether to go ahead with the proposal. *See id.* The parties agreed that the cost incurred by the Chinese visitors would be deducted from the profit of the venture at a later date. *See id.* The Chinese visitors went to the United States in 1995 and the parties signed a contract to set up a joint equity venture. *See id.* The municipal government did not approve the investment project. *See id.* The American party sought compensation from the Chinese party for the cost incurred from the visit and the trial court ordered the Chinese party to reimburse the American party for the cost plus interest on the principal. *See id.* The court of appeals, however, ordered the parties to share the cost under the relevant provisions of the Foreign Economic Contract Law. *See* 23 SELECTED CASES OF THE PEOPLE'S COURT 131-40 (Institute for Practical Legal Research of the National Supreme Court ed.) (Publishing House of the People's Court 1998) (in Chinese) (discussing another example, *Standard Chartered Asia Ltd. v.*

cally, those joint ventures that were subject to the Foreign Economic Contract Law would continue to be subject to the Code. In the past, contracts for establishing a sole foreign investment enterprise between several foreign investors were not normally subject to the Chinese law, as most of such contracts were made outside China. Whether a contract between several foreign investors for establishing a sole foreign investment enterprise made in China is subject to the Foreign Economic Contract Law is unclear. Arguably, the answer is yes because Article 2 of the Foreign Economic Contract Law expressly states that the Law applies to a contract made between a Chinese enterprise or other economic organization and a foreign enterprise or other organization.[234] Such a contract appears to be subject to the Code because of the wording of Article 2 of the Code.[235] This makes questionable the connection between the Sole Foreign Investment Law and the Code, namely whether satisfying the requirement of the Code is the prerequisite for the establishment of a sole foreign investment enterprise.

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*Huajian Company of Guangxi*). In this case, the Chinese party, a partner to a joint venture in which a Hong Kong company had invested, was actually the guarantor of its joint venture partner, the Hong Kong company. *See id.* The plaintiff bank sued the guarantor for the loan borrowed by the Hong Kong company. *See id.* The court of appeals decided the case partially on the basis of the Foreign Economic Contract Law, and ordered the Chinese party to pay the debt and its interest on behalf of the Hong Kong party. *See id.; see also* 16 SELECTED CASES OF THE PEOPLE'S COURT 144-51 (Institute for Practical Legal Research of the National Supreme Court ed.) (Publishing House of the People's Court 1996) (in Chinese) (discussing the case of *Jianling Car Accessories Company Ltd. of Huanghua v. Jianshen Company Ltd. of Taiwan,* which is also a dispute involving a joint equity venture between a mainland company and a Taiwanese company).

233. *See* 23 SELECTED CASES OF THE PEOPLE'S COURT 166-71 (Institute for Practical Legal Research of the National Supreme Court ed.) (Publishing House of the People's Court 1998) (in Chinese) (discussing the case *Flying Dragon Company of Nanjing v. Korean Sanjin Co. Ltd*, in which the parties concluded a contract to establish a joint co-operative venture in 1994). The Korean party alleged that the Chinese party forged its signature on a number of documents concerning the venture and that the Chinese party failed to make capital contributions as agreed and requested to terminate the contract. *See id.* The court applied the relevant provisions of the GPCL and found both parties had breached the contract, thus dismissing the claims and cross-claims accordingly. *See id.*

234. *See* FOREIGN ECON. CONT. L., *supra* note 5, art. 2.

235. *See* C. CONT. L., *supra* note 2, art. 2.

The contract for establishing a joint equity venture is also ambiguous under the Foreign Economic Contract Law since the Foreign Joint Equity Venture Law was passed in 1979 and the Foreign Economic Contract Law was passed in 1985. There is no specific provision in the Foreign Economic Contract Law to deal with the joint equity venture contract, which is different from a joint cooperative venture, and it is unclear whether a joint equity venture must also comply with the Code to make a contract for the establishment of a venture before setting up a joint equity venture under the Joint Equity Venture Law. The joint cooperative venture is a contractual arrangement in nature, while the joint equity venture is more like a company. This is why more joint cooperative venture contracts than joint equity venture contracts were actually subject to the Foreign Economic Contract Law. Presently, the relationships between these forms of foreign investment, which are largely of contractual nature, and the Code are unclear, even though the General Principles of the Code can apply to any type of contract in China.

The Code does not expressly regulate contracts for establishing foreign investment enterprises. On the other hand, Article 126 of the Code states that the joint equity venture contracts, the joint cooperative venture contracts, and the contracts for joint exploitation and exploration of natural resources are subject to the law of the PRC if they are performed within the Chinese territory.[236] Does this provision mean that the Code should regulate the said contracts, and if yes, how so? If no, what is the meaning of Article 126, which purports to deal with issues relating to the governing law of a contract? Assume Article 126 intends to make the Code applicable to the contracts for establishing joint equity ventures and joint cooperative ventures in the PRC. The Code is only capable of applying to such contracts under its own Article 124, which provides that contracts that are not expressly regulated in the Specific Rules of the Code and any other laws, should be dealt with under either the General Principles of the Code or by analogy to the Specific Rules of any other laws. The problem with foreign investment enterprises is that none of the foreign investment laws (i.e., the Joint Equity Venture Law, the Joint Cooperative Venture Law, and the Sole Foreign Investment Enterprise Law) expressly regulate the contracts for establishing the

236. *See id.* art. 126.

relevant ventures. It appears that such contracts are still largely subject to the present laws on foreign investment enterprises. Ambiguity and dispute may arise from time to time not only from the relevant commercial practice but also from the relevant judicial decisions after October 1, 1999.

### C. INCONSISTENCIES ARISING FROM CERTAIN PROVISIONS OF THE CODE

A number of inconsistencies appear as a result of the wording of the Code. Some of the inconsistencies are explicit, while others are implicit. Some of the inconsistencies may be reconcilable by interpretations of courts. The Code sets forth rules for determining when a contract becomes effective. Several provisions regulate the same issue from different perspectives. It appears, however, that a number of provisions are inconsistent or may lead to inconsistent consequences in their operations. For example, Article 25 of the Code states that when an acceptance becomes effective, the contract is concluded.[237] While this provision appears self-evident, if it is read together with Article 32 a problem may arise. Article 32 of the Code states that when the parties adopt a standard form contract, the contract is concluded when the parties sign or seal the contract.[238] Both provisions regulate the time when a contract is deemed concluded, but one says that a contract is deemed concluded when the acceptance becomes effective while the other says that a contract is deemed concluded when both parties sign and seal the standard form contract. Does the making of a standard form contract or a contract made in a standard form also require offer and acceptance? If it does, then how do we determine the time of the conclusion of the contract? The effectiveness of an acceptance and the signature or sealing of a contract are different matters. What if there were both the acceptance and signature or sealing in the making of a standard form contract? Whether the uncertainty can be resolved by judicial interpretation remains to be seen. Can the court really define a special manner in which a standard form contract can be made under the Code?

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237. *See id.* art. 25.

238. *See id.* art. 32.

There also exists some inconsistency between Article 25 and Article 35 of the Code, which states that if a contract is made in a standard form contract, the place where the parties sign or seal the contract is the place where the contract is concluded. Under Article 25, the contract, whether written or oral, is concluded when the acceptance becomes effective.[239] Article 34 supplements Article 25 by saying that the place where an acceptance becomes effective is the place where the contract is concluded.[240] What, then, is the relationship between Articles 25, 34, and 35, because they all have something to do with the place of contract? If we have a case where the parties communicate by offer and acceptance first, and later decide to make a contract in a standard form, how are Articles 25, 34, and 35 to be applied? If Article 35 applies, then Articles 25 and 34 are arguably superseded.

The time when a contract becomes effective is also regulated in Article 140, which states that if the subject of a contract was in possession of the buyer prior to the conclusion of the contract, the time on which the contract becomes effective is the time of delivery.[241] If delivery means the delivery of the goods under Article 140, then the contract for the sale of the goods concerned comes into effect before the contract is ever made. This provision provokes wonder regarding the proper meaning of when a contract becomes effective. If a contract that becomes effective means a contract is enforceable or binding upon the parties, how can a contract become effective before it is made? This is the first problem with Article 140.

The second problem with Article 140 arises when it is read in conjunction with Article 25—the same difficulty discussed between Articles 25 and 32, or 35 arises. A contract is deemed concluded when the acceptance becomes effective under Article 25. If the goods were lent to a party under an agreement, and later the parties agree to sell the goods to the party in possession of the goods, the offer and acceptance actually take place between the parties after the party in possession has taken over the goods. Article 140, however, gives the contract made at a later date a retroactive effect from the

239. *See id.* art. 25.

240. *See* C. CONT. L., *supra* note 2, art. 34.

241. *See id.* art. 140.

time when the goods are initially delivered for some purpose other than the purpose of sale to the party who becomes the buyer at a later date. How can a contract be effective even before offer and acceptance is made? Articles 25 and 140 cannot be reconciled unless Article 140 prevails over Article 25. Is this a correct interpretation of the relationship between the provisions?

Article 2 of the Code is ambiguous and potentially litigious. The provisions appear to cover government contracts or any contracts made by an organization that does not have the independent economic capacity to perform a contract by suggesting that any natural or legal person and other organizations may become a party to a contract. If an organization is qualified and registered as a legal person, the organization is a legal person. If an organization is not a legal person, it can still make a contract under Article 2.[242] Such organizations include certain educational institutions which are not legal persons, the representative office (of a legal person) which is not a legal person on its own, local residents' committees, villagers' committee, social or political organizations or groups, and government departments or offices. Any organization or social group that does not have the capacity of a legal person or a natural person may make a commercial contract as an "organization." Article 2 appears to be a huge jump forward in the Chinese contract law theories in the sense that the innocent party may be given more protection than under the previous contract laws. The National Supreme Court expressed a view that an organization, which is neither a legal person nor an economic organization, nor an agent of another person with the capacity to make a contract, has no contract-making capacity. The contract made by such a person is therefore void.[243] The meaning

242. *See id.* art. 2.

243. *See* 1 HEZHENG WU ET. AL., COLLECTIONS OF THE RECENT ECONOMIC AND CIVIL CASES AND JUDICIAL INTERPRETATIONS 37 (Publishing House of Industry and Commerce, 1997) (discussing a ruling by China's National Supreme Court on March 24, 1988, in a reply to the Provincial Supreme Court of Inner Mongolia, which stated that if a representative office of a legal person is not qualified as a legal person itself and there is not anyone capable of performing the contractual obligation to provide the guarantee, the contract made by the representative office is deemed to be void); *see id.* at 54 (discussing a similar view on November 8, 1988 by the National Supreme Court in response to an inquiry made by the Provincial Supreme Court of Fijian).

of "organization" under Article 2 is not defined anywhere in the Code. Thus, arguably, a contract previously regarded as void under the relevant instruction of the National Supreme Court will probably be regarded as enforceable under Article 2. Although the views expressed by the National Supreme Court will be superseded by the Code, the rationale which formed the basis of the views of National Supreme Court is not answered by the Code, thus giving rise to a possibility of litigation in the future.

Government contract under Article 2 may be another area where litigation may arise. It appears that a government department or agent should be liable in the same way as any natural or legal person under Article 2. This presumption, however, is qualified by Article 38 of the Code, which states that where the State issues directive orders of purchase according the needs of the State or where the State makes an order of purchase, the legal persons and other organizations concerned should conclude a contract in pursuance of the relevant laws and regulations concerning their rights and obligations.[244] Article 38 appears to suggest that a government organization, any legal person, or organization for that purpose, is not required to comply with the general rules of contract when making a contract under State instructions or on behalf of the State.

The meaning of State "order of purchase" is unclear. Does this expression include any type of commercial contracts signed by a government, or only a specified type known as the State "order of purchase?" If the expression takes a broad meaning, all government contracts will not be subject to the rules of the Code, even though Article 2 appears to apply to the government contract. If so, how do we draw a line between a contract made under the State plan and a contract made for the purpose of satisfying normal commercial needs of a government department or agency, such as an order to purchase foods or furniture. If the expression takes a narrow meaning, the State "order of purchase" must be specifically defined. If a government department or agent is liable in the same way as a natural or legal person in a commercial contract of common nature, does this imply the acceptance of the doctrine of restrictive sovereign immunity by the Chinese Government?

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244. *See* C. CONT. L., *supra* note 2, art. 38.

The doctrine of restrictive sovereign immunity is a relevant issue because China is not formally giving up the doctrine of absolute sovereign immunity even though it appears to be following the doctrine of restrictive sovereign immunity in practice. In addition, will Article 38 be used as a leverage of convenience for a government department or agency to avoid its contractual obligations under a commercial contract? If so, a natural or legal person must be careful in making any commercial contract with a government department or agency even though they appear to be equal under Article 2.

### D. LIABILITY ARISING FROM NEGOTIATION OF CONTRACT

A new feature of the contract law of the PRC is Article 42 of the Code, which generally states that a contracting party is liable for compensation if he or she commits one of the following acts and his or her act has caused damage to the other party: [245] (1) takes the opportunity of negotiating a contract for some ill intent or purpose; (2) deliberately conceals or refuses to disclose important facts and information which affect the making of the contract, or intentionally provide false or misleading information to the other party; and (3) other acts which contravene the principle of good faith.

This provision is important for both foreign and Chinese companies and businesspersons alike. It is incorporated into the Code for the purpose of protecting the innocent party who suffers a loss during negotiations, which do not ultimately lead to the conclusion of a formal contract. In the past, both foreign and Chinese parties experienced and complained about each other's lack of good faith in defrauding, misleading, or double-dealing the other in negotiations. Some of these acts may fall under the scope of equity in a common law jurisdiction, but there did not exist an adequate remedy in Chinese law until the passing of the Code. The Code now gives adequate protection and compensation to the innocent party who sustains loss because of the said acts of the other party during the negotiation. From October 1, 1999 forward, a foreign company or businessperson may resort to Article 42 and other relevant provisions for compensation if the company or person suffers loss because of the other party's breach of Article 42. On other hand, the company and person

245. *See id.* art. 42.

must be careful not to commit any act that may be caught by Article 42. In fact, strong complaints were voiced by many Chinese mainland companies and businesspersons against their counterparts from foreign countries and places outside the mainland, such as Hong Kong, Taiwan, and Macau, who have disappeared from the mainland after having signed preliminary intent forms for joint ventures, cooperation, or real estate development in the mainland, causing damages to the local governments and partners.

The application of Article 42 may be problematic and uncertain in some circumstances. For example, Article 42(1) refers to an act of pretending to negotiate a contract with ill intent. How can we separate an act of pretending to negotiate a contract with ill intent from an act of changing one's mind during negotiations? In the absence of an express admission of any ill intent from a party, how do we know the other party has simply pretended to negotiate? The court must exercise considerable discretion in applying the provision. Article 42(2) is more certain than Article 42(1) because Article 42(2) applies to intentional concealment of important facts or supplying of false information. Such acts are easier to identify than the acts proscribed by Article 42(1). Article 42(3) is very broad and covers any acts that violate the principle of good faith. Very broad judicial discretion must be granted to the court when applying this provision. As previously discussed, the meanings of Article 42 are yet to be clarified and defined by the Chinese court.

Article 43 of the Code also purports to deal with liabilities arising from negotiations, which may or may not lead to the conclusion of a contract. This provision states that the parties cannot inappropriately use or disclose the commercial secrets obtained by them during negotiations, regardless of whether or not a contract is made.[246] The party that discloses or inappropriately uses the said commercial secrets and causes damages to the other party shall be liable for the damages so caused. This provision is similar to what is known as the "duty of confidentiality" in the common law tradition. Article 43 appears to require the parties to clearly state to each other what is regarded as a commercial secret to avoid dispute. In the absence of a common understanding, however, the court may apply common and

246. *See id.* art. 43.

reasonable standards to decide the confidentiality of the information concerned. In sum, both Articles 42 and 43 operate together to offer better protection to parties in negotiations that do not lead to the ultimate conclusion of a contract.

### E. FLEXIBILITY OF THE WRITTEN FORMALITY

The Code recognizes the effect of both written and oral contracts in Article 10. The second paragraph of Article 10 states that if the relevant laws and regulations require, or the parties agree on, the use of a written contract, the contract shall be made in writing.[247] This provision appears to suggest that sometimes a contract must be made in writing. This provision, however, also appears to have been qualified by Article 36 of the Code, which states that when the relevant laws and regulations require or the parties agree to make a contract in writing and one of the parties has performed his or her major obligations prior to the conclusion of the written contract, the contract is concluded without the written form if the performance has been accepted by the other party. This provision suggests that even if a contract must comply with the written formality because of the stipulation of the relevant law and regulations or the agreement of the parties, the written formality can be waived by the performance of one party and acceptance of that performance by the other party. When reading Articles 10 and 36 together, the conclusion is that Article 36 overrides Article 10 if the parties agree by conduct that a written contract is not necessary.[248]

Article 36 does not appear to have any problem if the written formality is required by the agreement of the parties. However, if law and regulations require the written formality, the scope of Article 36 may be uncertain. Does Article 36 really mean that the parties may circumvent the written requirement of the relevant law and regulations to make a contract by conduct? If so, can the contract agreed upon by the conduct of parties and the written contract stipulated by the relevant law and regulations be reconciled given that there may be special or technical reasons for the law and regulations to require that a contract be made in writing? Can Article 36 be interpreted as

247. *See id.* art. 10.

248. *See id.* art. 36.

saying that a contract is concluded by the conduct of the parties, but shall be later evidenced in writing as required by the relevant law and regulations? Such an interpretation is not unlikely if a court intends to reconcile Articles 10 and 36 of the Code in the future.

Also relevant to the issue of formality, Articles 32 and 37 of the Code appear to have the same problem as Articles 10 and 36. Article 32 regulates the making of a standard form contract.[249] Under this provision, a standard form contract is concluded when the parties sign or seal the standard form of the contract. Article 37 makes an exception to Article 32 by stating that in a standard form contract, when one of the parties has performed his or her major obligation prior to the signing or sealing of the contract and the other party accepts the performance, the contract is concluded.[250] Article 37 overrides Article 32 in the sense that the requirement for signature or sealing, which is regarded as the indicator of the conclusion of a standard form contract, can be waived by the parties' performance of the major obligations and acceptance of the performance. Article 37 does not appear to cause any problem in its application, unless laws and regulations require the use of a standard form contract. If so, Article 37 may encounter interpretation problems similar to those encountered by Articles 10 and 36.

## CONCLUSION

The Code is a comprehensive document that was designed to apply to all types of contracts that are subject to Chinese law. As previously discussed, it is supplementary to the Vienna Sales Convention in an international sale of goods transaction. While many aspects of sale may be subject to the Code, others are subject to the Convention. In addition, a provision of the Code may apply to a sale governed by the Convention if there is no inconsistency between the Code and the Convention. In a situation where the Convention does not apply, the Code becomes the only law governing sales involving parties from mainland China and parties outside mainland China. For example, a contract of sale between a company from mainland China and a company from Hong Kong, Macau, or Taiwan may be subject to the

249. *See* C. CONT. L., *supra* note 2, art. 32.

250. *See id.* art. 37.

Code under the conflict of law rules of the PRC. Accordingly, the Code is important to everyone conducting businesses with China.

This Essay only discusses the relationship between the Code and the Convention and a number of principal features of the Code. In fact, all types of commercial contracts, such as a service contract, a loan agreement, or a transfer of technology contract made in China or with a Chinese party may be subject to the Code. A number of basic principles of contract law discussed in this Essay are also important for any other types of contract. As aforementioned, contracts for the establishment of foreign investment enterprises are not specifically regulated by the Code. Thus, only the general principles of the Code apply to such contracts. In the absence of specific rules, a foreign investor in China also needs to consider the relevant foreign investment law. The precise boundary between the Code and the relevant foreign investment law in relation to a contract for the establishment of a foreign investment enterprise has yet to be ascertained by the courts. In this regard, the outer limit of the Code is yet to be demarcated by the court or the Standing Committee of the NPC.

In sum, the Code of Contract Law is good news for foreign companies and businesspersons that deal extensively with Chinese companies and businesspersons. Contractual principles and specific rules become transparent and ascertainable under the Code, thereby reducing and preventing the abuse of judicial discretion in handling disputes arising from contracts. Although the Code is not perfect, it does constitute an important step for the PRC toward the rule of law. The Code offers theoretical bases for developing contractual rules relating to many other types of contracts that are not specifically addressed in the Code. Ultimately, the application and efficiency of the Code are yet to be tested. Accordingly, amendments are to be expected in the forthcoming years, as they become necessary.