■

No Longer a 'Tool of the State Plan'? An Analysis of the 1993 Amendments to China's Economic Contract Law

Introduction

When the Economic Contract Law of the People's Republic of China (PRC)[1] (the '1981 ECL') was first adopted in December 1981, it was considered a substantial step toward reform and liberalisation of the economy. Unlike prior PRC contract regulations, the ECL listed (in Article 1) the protection of the rights of the parties as a fundamental purpose of the law. As one commentator observed, the ECL 'promoted the autonomy of economic actors to engage in increasingly diverse economic transactions ... [and] emphasised the rights of the contracting parties to a greater degree than previously evident in China.'[2] The fact that the 1981 ECL was a law (rather than a mere regulation) was also considered important, as it gave a certain 'durability' to the economic reform policies of the Third Plenum.[3]

Nonetheless, the 1981 ECL stressed also traditional socialist principles. Economic contracts were expected to serve the interests of the Chinese economy as a whole, helping it to improve economic results and to guarantee the implementation of state plans.[4] And, indeed, the actual provisions of the 1981 ECL indicated that, despite the rhetoric of Article 1, the ECL was not originally intended to serve as a general law of contract for private transactions. Rather, it was drafted to provide a means of enforcing state economic plans, with the 'contracts' made under the ECL serving as vehicles for translating the plan into obligations of particular production units and holding units accountable for their production quotas.[5]

Thus, the capacity to form a contract under the 1981 ECL was restricted[6] and state control over all economic contracts was expressly retained. As one PRC commentator noted:

1 The Economic Contract Law of the People's Republic of China, adopted 13 December 1981 by the Fourth Session of the Fifth National People's Congress (the '1981 ECL'). An English translation of the 1981 ECL is published in Jerome A Cohen (ed), *Contract Laws of the People's Republic of China* (Hong Kong: Longman Group (Far East) Ltd, 1988), pp 49–68. The 1981 ECL was also published (in Chinese and English) in CCH Australia Ltd, *China Laws for Foreign Business: Business Regulation* (1993), Vol 1, paras 5-500(7)–(57). (This publication of the 1981 ECL has been replaced with the updated law, but is on file with the author.)

2 Pitman B Potter, *The Economic Contract Law of China: Legitimation and Contract Autonomy in the PRC* (Seattle: University of Washington Press, 1992), p 5. Potter noted that no contract regulations enforced from 1949–78 emphasised the rights of the parties to the contract. Ibid, p 184, n 11.

3 Ibid, p 43.

4 1981 ECL (note 1 above), Art 1.

5 Henry Zheng, 'A Comparative Analysis of the Foreign Economic Contract Law of the People's Republic of China' (1986) 3 China Law Reporter, No 4, 227, 235.

6 See 1981 ECL (note 1 above), Arts 1 and 54, discussed at p 419 below.

> Economic Contract Law in China is a socialist economic contract law. One essential principle it observes is allowing the planned economy to play the dominant role, that is economic contracts must subordinate themselves to the state plan. Economic contracts are a powerful tool in ensuring implementation of the state plan. This is one major feature that distinguishes the socialist Economic Contract Law.[7]

However, in the decade following the enactment of the ECL, the pace of privatisation increased and the law was criticised as being outdated, out of step with reality, and inconsistent with more recent laws.[8] Thus, in September 1993, the Standing Committee of the Eighth National People's Congress adopted substantial amendments to the 1981 ECL.[9] Together with the new Company Law and the Law Against Unfair Competition, the Amended ECL was presented as a 'package' of legislation designed to further China's economic reforms and the development of its 'socialist market economy.'[10]

The amendments to the 1981 ECL give rise to two questions. First, to what extent do the amendments actually reduce the power of the state to control economic contracts and to use them as 'tools' of economic planning? Second, assuming that two parties *are* permitted to enter into and perform a contract without government interference, does the Amended ECL provide them with the legal certainty that they require?

This article considers these two questions in the context of the amendments made to the 1981 ECL. It does not discuss the amendments in the order that they appear in the Amended ECL, but rather attempts to analyse them as they affect certain important areas of contract law. Thus, the first two parts consider the importance of state plans and state 'management' of contracts under the ECL. The next part discusses the formation and terms of contracts. The fourth

7 Gu Ming, 'The Economic Contract Law is a Powerful Tool in Ensuring Implementation of the State Plan' (1985) 18, Chinese Law and Government, No 1, 50, 50–1. Gu Ming originally published this view of economic contracts in Faxue Zazhi (Legal Studies Magazine), No 3, pp 7–9 (May 1982). At the time, he was vice-chairman of the Commission on Legislative Affairs of the NPC Standing Committee and his views have been described as reflecting 'the convergence of interest and attitudes between the China Law Society and the conservatives among the central party leadership': Potter (note 2 above), p 201, n 23.

8 See, eg, 'Economic Contract Law Amended to Suit Realities,' Xinhua General Overseas News Service (LEXIS), 22 June 1993; 'Zou Jiahua Presides Over State Council Meeting on Economic Laws,' BBC Summary of World Broadcasts (LEXIS), 1 June 1993.

9 Economic Contract Law of the People's Republic of China, adopted 13 December 1981 by the Fourth Session of the Fifth National People's Congress, amended 2 September 1993 in accordance with a decision made at the Third Session of the Standing Committee of the Eighth National People's Congress (the 'Amended ECL'). The Amended ECL has been published in Chinese with an English translation in CCH Australia Ltd, *China Laws for Foreign Business: Business Regulation* (1993), Vol 1, paras 5-500(2)–(47). The Amended ECL does not make any reference to articles that appeared in the 1981 ECL but were repealed as a result of the 1993 amendments. For the actual amendments (in Chinese and English, including the numbers of the articles that were deleted), see China Law & Practice, 18 November 1993, pp 40–6.

10 'NPC Standing Committee Session: New Laws Needed to Run Successful Socialist Economy,' BBC Summary of World Broadcasts, 5 July 1993 (LEXIS) (source, New China News Agency domestic service).

part considers amendment, termination and excuses for non-performance (which are unfortunately grouped together in one article of the ECL). The last part considers the enforcement of contracts and remedies for breach.

The role of the 'state plan'

As originally enacted, the 1981 ECL was replete with provisions that made clear that the primary purpose of economic contracts was to facilitate the implementation of state plans. For example, Article 4 required that economic contracts 'conform to the requirements of state policies and plans,' and forbade the use of contracts to 'undermine state plans.' Similarly, Article 7 provided that contracts that violated 'state policies and plans' were invalid from the time of their making.

The 1981 ECL could also be used to impose upon enterprises an affirmative duty to form contracts to implement state plans. Under Article 11, a contract that related to products prescribed in mandatory plans was to be formed in accordance with the production quotas set by the state. Contracts that related to products prescribed only in a 'guidance-type' (or 'indicative') state plan were subject to less stringent control. Article 11 permitted such contracts to be formed according to the 'actual conditions' of the parties, but still directed the parties to refer to the targets set by the state.

If the parties could not agree on a contract that would meet targets set forth in a mandatory plan, they were required (under Article 11 of the 1981 ECL) to refer the matter to their 'higher authorities' — the departments in charge of planning for the relevant sector. In some cases, the authorities might determine that the targets were unrealistic and revise them. But they could also simply put pressure on the relevant units to agree to terms that would implement the plan.[11] As Gu Ming observed, the 'directed planned targets are imperative and therefore the higher authorities in charge of planning are obligated to interfere.'[12] Thus, contracts relating to products prescribed in the 'mandatory' plans were far from voluntary agreements and were viewed more as administrative orders than as true contracts.[13]

The 1993 amendments to the ECL appear to declare an end to this dominance of state plans over economic contracts, as well as an intention to permit the increased use of the ECL for truly private transactions. The first significant change appears in Article 2, which substantially expands the capacity to enter into economic contracts. Under the 1981 ECL, economic contracts could be formed only between legal persons or between legal persons

[11] Gu Ming (note 7 above), pp 52–3.
[12] Ibid, p 53.
[13] Preston M Torbert, 'Contract Law in the People's Republic of China' in Michael J Moser (ed), *Foreign Trade, Investment, and the Law in the People's Republic of China* (Hong Kong: Oxford University Press, 2nd ed 1987), p 335.

and individual business households or commune members. The primary definition of capacity appeared in Article 2, which defined 'economic contract' to include only agreements between legal persons. However, Article 54 (which has now been deleted) also implicitly recognised economic contracts between legal persons and individual business households or commune members, by providing that such agreements should be formed 'with reference' to the 1981 ECL. The unusual placement of Article 54 (in the final chapter, entitled 'Supplementary Articles') has been attributed to the fact that it was essentially 'an afterthought geared to the narrow provisions of the rural household responsibility system.'[14]

In contrast, Article 2 of the Amended ECL now permits not only legal persons, but also 'other economic organisations, individual industrial and commercial households and rural contracting households' to enter into contracts (both with legal persons and with each other). Although it appears that many individual businesses and other entrepreneurs were relying upon the 1981 ECL even prior to this amendment,[15] it is still significant, as it offers greater certainty to those who may have been in doubt as to the enforceability of their contracts and will encourage others to use the Amended ECL in their business agreements. The amendment to Article 2 also makes clear that the drafters contemplate the increased use of the Amended ECL to form contracts that have little or no direct relevance to state economic plans and that will instead arise from the rapidly growing private sector of China's economy.

This is further evidenced by the fact that most of the references to state plans (including those in Articles 1, 4, and 7) have been deleted. The few that remain would appear to make the subordination of parties' agreements to state planning needs the exception rather than the rule. For example, although Article 11 continues to recognise that mandatory plans may be issued to enterprises, it no longer directs parties that cannot reach an agreement implementing the targets to refer the matter to their 'higher authorities.' This change implies that even in the case of products prescribed in mandatory plans, enterprises will no longer be compelled to enter into contracts that are not to their economic advantage.

It is, however, difficult to predict the actual impact of these changes. The General Principles of Civil Law still provides that any civil act which violates state mandatory plans is void from its inception.[16] Moreover, in almost all cases in which the phrase 'state plan' has been deleted from the ECL, it has been replaced with new (and potentially quite broad) restrictions. For example, while Article 4 no longer refers to state plans, it now requires that parties

[14] Pitman Potter, 'Economic Contract Law Revision,' China Law & Practice, 18 November 1993, p 47.
[15] Ibid.
[16] General Principles of the Civil Law of the People's Republic of China (the 'GPCL'), adopted at the Fourth Session of the Sixth National People's Congress on 12 April 1986, effective as of 1 January 1987, Art 58. An English translation of the GPCL is published in Cohen (note 1 above), pp 29–48.

concluding a contract must do so in accordance with 'laws and administrative regulations'[17] and that contracts should not be used 'to disrupt social or economic order' or to 'damage state or public interest.' Similarly, Article 7 declares invalid any contract that violates 'laws or administrative regulations' or the 'state or public interest.'

These new limitations are extremely vague and open to a number of interpretations. Given the nature of law-making in China, the government could easily use 'administrative regulations' as a vehicle for extensive interference in economic contracts. Indeed, there are already a vast array of administrative regulations authorising state interference in economic contracts.[18] Even if these regulations are all amended so as to decrease the role of state planning, the language of Articles 4, 7, and 11 would permit the government to re-emphasise it at any time without any further change to the Amended ECL itself.

Even the apparent decision to abandon the policy of compelling enterprises to enter into contracts implementing mandatory targets could easily be reversed. The amended version of Article 11 provides that should the state issue a mandatory production plan to enterprises, then the enterprises concerned 'shall sign the contracts based upon the rights and obligations of the enterprises as prescribed in the relevant laws and administrative regulations.' Thus, if an administrative regulation required enterprises to form contracts implementing mandatory plans, they would likely be required to do so under the Amended ECL.

This extensive use of the term 'administrative regulations' is particularly disconcerting in view of the lack of guidance in the Amended ECL as to what organs will have the authority to make such regulations. Article 56 of the 1981 ECL expressly gave departments under the State Council and provincial governments the power to make regulations for the 'implementation' of the 1981 ECL (with the proviso that any such regulations were subject to the approval of the State Council). However, this article was deleted by the recent amendments. Its removal may indicate an intention to reduce the power of administrative departments and local governments to legislate by means of regulations, a rational step in view of the increased significance of 'administrative regulations' under the Amended ECL. However, there are no comprehensive rules in the Chinese legal system governing the power to issue regulations or other subsidiary legislation.[19] Thus, it cannot be assumed that the mere

[17] This term is sometimes translated as 'statutory regulations.' See, eg, Art 4 of the CCH Australia translation of the Amended ECL (note 9 above).

[18] See, eg, the regulations, rules and implementing measures published in *China Laws for Foreign Business: Business Regulation* (note 1 above), Vol 1, and in Cohen (note 1 above), at pp 61–164. It was recently observed that 'there are more than a dozen sets of such regulations at the central government level plus a number of local regulations [relating to economic contracts]': Wang Guiguo, *Business Law of China, Cases, Texts and Commentary* (Singapore: Butterworths Asia 1993), p 44.

[19] Albert H Y Chen, *An Introduction to the Legal System of the People's Republic of China* (Singapore: Butterworths Asia, 1992), p 85.

deletion of the original Article 56 will deprive administrative departments and local governments of the power to issue regulations relating to the ECL.

At this early stage, perhaps the most that can be said of the amendments deleting the references to state plans is that they at least create a legal *presumption* (rebuttable by regulations) that enterprises will not be compelled to enter into unfavourable contracts to implement state plans and that parties should be permitted to form their own contracts, without making reference to state planning needs.

This shift in presumption can be seen not only in the general provisions discussed above, but also in provisions relating to specific types of contracts. For example, the original version of Article 20 stated that all contracts for the transportation of goods should be made 'in accordance with the goods allotment plan, transportation capacity and the transportation plan.' The amended version of Article 20 provides simply that such contracts 'shall be signed by the consignor and the carrier through consultation.' Similarly, Article 18 originally required that all contracts for construction projects be made in accordance with 'procedures prescribed by the State, the investment plans, project task certificates and other documents approved by the State.' The amended Article 18 subjects only contracts for 'major State construction projects' to these restrictions. Of course, all new buildings require at least some degree of official approval, if only in the form of building permits. However, since such permits are generally granted at the local level, the amendment to Article 18 would appear to decrease substantially the extent of central control over privately funded construction projects.

Thus, while the 1981 ECL viewed economic contracts primarily as a 'tool' of state planning, the Amended ECL clearly contemplates the existence of a significant number of contracts formed at the parties' own initiative and for their own economic benefit. This reduced significance of state plans raises the related issue addressed in the next section — the role of administrative authorities in overseeing and 'managing' economic contracts.

State supervision of economic contracts

As the 1981 ECL viewed economic contracts primarily as administrative orders implementing state plans, it naturally provided for extensive official supervision over the formation, terms, and performance of contracts. In addition to the power to make subsidiary regulations (discussed above), the original ECL gave administrative authorities three significant powers: (1) the power to declare contracts 'invalid' (contained in Article 7 and shared with the courts); (2) a general power to examine economic contracts and supervise their 'implementation' (contained in Article 51); and (3) the power to 'handle' cases in which parties used contracts for improper or illegal acts and to refer such cases to judicial organs if they involved criminal activities (contained in Article 53).

The only unambiguous amendment to these powers relates to the power to declare contracts invalid. Under the amended version of Article 7, contract administration authorities will no longer have this power, which will instead be shared by arbitration authorities and the courts. This is potentially a significant change. Under the 1981 ECL, a contract could be declared invalid even though no dispute had arisen between the parties. An enquiry could be commenced as the result of an inspection by an administrative bureau for industry and commerce or as the result of information from a third party.[20] In contrast, under the amended version of Article 7, the question of 'invalidity' is unlikely to be raised except by the parties themselves, in the course of an arbitration or court action. The drafters apparently determined that in light of the other amendment to Article 7 (eliminating violation of state plans as a ground for declaring a contract invalid), it was no longer necessary to give administrative authorities the power to investigate contracts for possible invalidity.

However, the amendments relating to other administrative powers over economic contracts are more ambiguous and difficult to interpret. Consider, for example, the power to examine and supervise the implementation of economic contracts. Under Article 51 of the 1981 ECL, the departments in charge of enterprises had a duty to see that economic contracts were performed:

> All responsible business departments and departments of industrial and commercial administration at all levels should supervise and examine economic contracts concerning them. They should establish systems of control. The responsible business departments at various levels should also regard the implementation of these economic contracts by enterprises as one of their economic indexes for checking.

In contrast, the revised version of Article 51, which is now numbered Article 44, provides:

> The various administrations for industry and commerce and other relevant competent departments of the People's Governments at county level or above shall, in accordance with the duties stipulated in the laws and administrative regulations, be responsible for the supervision of economic contracts.

[20] 'Interim Provisions of the State Administration for Industry and Commerce Concerning the Confirmation and Handling of Void Economic Contracts,' 25 July 1985, para III (1). These regulations are published (in Chinese and English) in *China Laws for Foreign Business: Business Regulation* (note 1 above), Vol 1, paras 5-560(I)–(III), and in English in Cohen (note 1 above), pp 160–4.

Thus the specific direction (to all administrative levels) to oversee the implementation of economic contracts, and to 'establish systems of control' for that purpose has been deleted. This would appear consistent with the amendments to Article 11 (discussed above), which deleted the requirement that enterprises that cannot agree upon contracts implementing mandatory targets must refer the matter to their 'higher authorities.'

Yet the new Article 44 still appears to give administrative organs at county level and above a general power to 'supervise' all economic contracts, subject only to the limitation that such supervision must be 'in accordance' with relevant laws and regulations. This new provision could be interpreted narrowly, as stating that administrative organs have only the power to supervise economic contracts where a law or regulation expressly directs them to do so. However, it might also be interpreted broadly, as stating that so long as an administrative authority does not *violate* any laws or regulations, it may exercise a general power of supervision over all economic contracts within its jurisdiction. Of course, even the narrow interpretation would permit extensive official intervention so long as it was expressly provided for in administrative regulations.

The third power to be considered is the power of administrative departments to address unlawful acts committed in connection with an economic contract. Once again, the main effect of the amendments has been to introduce more ambiguity and uncertainty into the ECL. Article 53 of the 1981 ECL gave administrative departments wide powers to investigate and 'handle' a number of unlawful acts:

> All unlawful deeds such as the signing of false economic contracts, the reselling of economic contracts, speculation under the disguise of economic contracts, profiting from the transfer of economic contracts, unlawful transfer of economic contracts, the offering and accepting of bribes, and other unlawful deeds that may harm the State and public interests will be handled by departments of industrial and commercial administration. If circumstances occur [such] that responsibilities for crimes should be affixed for these deeds, they should be handed over to judicial departments for handling.

The most significant change to Article 53 (which is now numbered Article 45) is that all of the specific references to prohibited acts have been deleted and replaced with a general reference to prohibited acts. Thus, Article 45 of the Amended ECL now provides:

> If a party uses economic contracts to act in violation of the law so as to harm State and public interests, it shall be handled by the administration for industry and commerce and other relevant departments of the People's

> Government at county level or above, in accordance with the duties stipulated in the laws and administrative regulations. Should the act constitute a crime, criminal liability shall be pursued in accordance with the law.

Thus, administrative departments continue to exercise the power to 'handle' prohibited acts, but there is now far less guidance as to the type of acts that these departments will be expected to police. The first sentence of the amended Article 45 could be interpreted so as to narrow its scope to include only acts that violate the criminal law. However, this seems unlikely, as the final phrase (in both the original and amended versions) clearly contemplates the existence of acts that do not constitute criminal offenses, but nonetheless violate the ECL 'so as to harm the State and public interest' and may attract administrative punishment.

The only other change to this provision is the addition (once again) of the cryptic phrase 'in accordance with the duties as stipulated by laws and administrative regulations.' One hopes that this phrase will be interpreted so as to limit administrative departments' jurisdiction under the amended Article 45 to include only those acts expressly prohibited by published regulations. But it might also be interpreted as providing that so long as the authorities do not act contrary to any applicable regulations, they have a general power to 'handle' acts which do not amount to crimes but which violate the ECL so as to harm the state or public interest.

Thus, the drafters took a similar approach to the question of 'state management' of contracts as that taken with respect to the role of state plans: the amendments appear to state an intention to decrease official control over economic contracts, but retain the power to interfere in the event that it is deemed desirable to do so. In view of the frequent and unpredictable changes in China's economic policies (particularly with regard to the pace of privatisation and the role of state planning), it is impossible to predict the extent to which administrative authorities will exercise this power to intervene.

Another important modification is to Article 13, which governs the form of payments under an economic contract. It originally provided that contractual obligations 'should be settled by means of bank account transfer, except those which are permitted by the State to be settled in cash.' This permitted banks to monitor closely the performance of economic contracts. Indeed, banks were expected to use their powers over account transfers as a means of ensuring the performance of economic contracts and the fulfilment of state plans. The amended version of Article 13 gives parties somewhat more flexibility. Although cash transactions still require the state's permission, parties now have a general right to settle accounts with negotiable instruments. Clearly, government will continue to use banks as a vehicle for controlling the economy as a whole. But this amendment (together with the deletion of

Article 52) indicates an intention to reduce bank supervision over the day-to-day performance of economic contracts. This change is consistent with the conclusion that although the Amended ECL has retained government's *power* to interfere with economic contracts, the drafters anticipate that in practice economic contracts will be used less as a means of implementing state plans and more as a tool to facilitate private economic transactions.

Of course, that conclusion raises the question of whether the Amended ECL will provide parties with the autonomy and legal certainty that they require for truly 'private' economic contracts. With that question in mind, I now consider the amendments to the ECL regarding the formation and terms of economic contracts.

Formation and terms of economic contracts

There has been little change to the requirements for formation of a contract under the ECL. Article 3 was not amended and continues to require that a contract be made in writing unless it is 'settled immediately.' It is somewhat surprising that the drafters did not relax this requirement. Granted, written agreements have certain advantages, such as helping to prevent misunderstandings and disputes over the terms. But a general requirement that economic contracts be made in writing is unduly restrictive, particularly in the context of contracts between small businesses, which often take the form of an oral order for goods or services.

The failure to delete the writing requirement may reflect the government's desire to continue to monitor economic contracts. The presence of a written agreement makes it easier to detect an economic contract that may 'harm State interests or the public interest' and warrant intervention pursuant to amended Article 45 (discussed above). This concern may also have influenced the decision to continue the presumption against cash transactions. As noted earlier, although Article 13 now permits parties to make payments by negotiable instrument, it continues to prohibit payments in cash unless expressly permitted by the state. Clearly it is easier to detect a prohibited transaction if there is a paper record of its performance.

However, the decision to retain the writing requirement may also have been influenced by the fact that oral contracts would have required the drafters to address the concepts of 'offer and acceptance,' which have never been included in the ECL.[21] It is unfortunate that the drafters did not add provisions relating to offer and acceptance, as they are important tools of contract analysis, in civil

[21] Interestingly, it has been argued that despite that lack of any reference to offer and acceptance in the ECL itself, 'official and unofficial documents issued by the Chinese government and related bodies and cases all regard offer and acceptance as indispensable in the process of contract making': Wang Guiguo (note 18 above), p 50, n 16.

as well as common law systems.[22] Indeed, they can be useful even where the parties have attempted to record their agreement in writing. For example, the rules of offer and acceptance may be used to resolve the 'battle of the forms' in which the parties send each other letters or standard-form contracts containing conflicting terms, never sign either version, but proceed to perform as though they had reached an agreement.[23]

However, with regard to the actual terms of the contract, the amendments to the ECL have the potential to increase party autonomy significantly. For example, the original version of Article 5 required that contracts implement the principle of 'compensation of equal values,' which could be interpreted to require overall equality of benefits to each party, as well as a sharing of losses if the venture is not successful.[24] This reference has now been deleted, apparently reflecting the abandonment by the Chinese government of the policy that exchanges must be of 'equal value' and that the exchange relationship must be equal.[25] Article 5 now contains only a general reference to the principle of 'equality and mutual benefit,' which is also expressed in the Foreign Economic Contract Law[26] and in the United Nations Convention on Contracts for the International Sale of Goods.[27]

The deletion of the requirement of 'compensation for equal values' implies that a party with exceptional bargaining power (for example a party selling goods that are in very short supply) should be free to use its bargaining power to demand an exceptionally high price. It should be noted, however, that the General Principles of Civil Law continues to require that all civil activities be carried out in accordance with the principle of 'exchange of equivalent values.'[28] But, since Article 5 of the Amended ECL specifically addresses economic contracts, it would likely prevail over the general principles expressed in the GPCL.[29]

22 See Michael H Whincup, *Contract Law and Practice: The English System and Continental Comparisons* (Deventer: Kluwer Law & Taxation Publishers, 1992), pp 31–47.

23 Ibid, pp 35–8 and 42–6.

24 Article 5 of the 1981 ECL has been described as a reflection of the 'reciprocity norm' in Chinese contract law. Roderick W Macneil, 'Contract in China: Law, Practice, and Dispute Resolution' (1986) 38 Stanford Law Review 303, 392. Macneil's study of Jinji Hetong Jiufen Xuanbian (Selected Cases on Economic Contract Disputes) revealed that the reciprocity norm was also an important element of Chinese contract law prior to the enactment of the ECL, and indeed that it was 'perhaps the most pervasive norm' in the cases he studied. Ibid, p 341.

25 Potter (note 14 above), p 48.

26 Foreign Economic Contract Law of the People's Republic of China, Adopted 21 March 1985 at the 10th Session of the Standing Committee of the 6th National People's Congress (the 'FECL'), Art 3. The FECL applies only to economic contracts between PRC enterprises and foreign parties, and embraces many Western principles of contract. The FECL is published, in Chinese and English, in *China Laws for Foreign Business: Business Regulation* (note 1 above), Vol 1, paras 5-550(5)–(43). An English translation of the FECL is also published in Cohen (note 1 above), pp 165–9.

27 United Nations Convention on Contracts for the International Sale of Goods (1980) ('the Convention'), preamble. For the text of the Convention as ratified by China (with effect from 1 January 1988), see China Law & Practice, 11 June 1987, p 24.

28 GPCL (note 16 above), Art 4.

29 In some areas, however, the GPCL provides quite specific rules of law, filling in gaps in the ECL itself. Certain of these provisions are noted below.

The policy of giving parties increased autonomy over the terms of their agreements is also expressed in the amendments to the specific provisions of the ECL governing purchase and sales contracts. For example, under the original version of Article 17(3), product prices were normally to be 'set in accordance with the prices set by the departments in charge of prices at various levels ...' The parties could agree upon their own prices only '[w]here negotiated prices [were] allowed by policy.' However, as amended, Article 17(3) states that product prices 'shall be set by the parties concerned through consultation, unless the State stipulates that prices fixed by the State must be used.' Thus, the Amended ECL retains the power of the state to set prices, but reverses the presumption in favour of the market.

In the event that the state exercises its power to set prices, changes to the state-fixed price made during the term of the contract can operate retroactively. Article 17(3) continues to provide that where the state-fixed price is changed after a contract is formed but before the goods are delivered, the price shall be determined according to the state-fixed price at the time of delivery. This could obviously cause significant hardship to one of the parties. It will also discourage parties from entering into any long-term contracts for such products, since a contract with a longer term runs a greater risk of being 'amended' by a change to the state-fixed price of the goods. The only exception to this general rule is that a party that performs late cannot benefit from a change made to the state-fixed price prior to its performance. This exception can be found in Article 17(3), which provides that if the seller of state-fixed priced goods delivers late, then the price of the product shall reflect a decrease, but not an increase in the state-fixed price. The buyer is similarly penalised if it delays accepting or paying for the goods.

The amendments to the provisions relating to guarantees also provide for increased party autonomy. Article 15 originally required that any guarantee be given by 'the unit specialised in making guarantees' and stipulated that the guarantor would be jointly liable for compensating any losses incurred as a result of the primary party's failure to perform the contract. In contrast, the amended version of Article 15 sets forth no restrictions on who may serve as a guarantor and permits the extent of the guarantor's liability to be determined by the contractual documents, stating simply that 'the guarantor shall perform the contract or assume joint liability *according to the terms of the guarantee agreement*' (emphasis added).

The amendments appear also to provide for some increased autonomy with respect to the terms of loan contracts. Article 45 of the 1981 ECL provided, as an implied term for all loan contracts, that if a borrower failed to use the loan as prescribed in the contract (for example, for the purposes specified in the contract), it must pay additional interest and the lender would have the right to recall all or part of the loan ahead of schedule. This provision (renumbered

as Article 40) has been amended slightly, so as to impose this requirement only where the contract is for a 'policy loan,' a term that appears to refer to a loan issued pursuant to a special government policy. It is difficult to predict the actual impact of this change. Government has clearly retained the power to condition loans on policy goals and is likely to continue to exercise significant control over the types of industries that receive loans and are thereby encouraged to develop. But the amendment to Article 40 may indicate an intention to de-emphasise policy considerations in individual loan contracts. Perhaps this is an example of what the Communist Party views as the shift from direct intervention in transactions to more indirect 'macro' economic controls.

Thus, the amendments to the ECL generally purport to give parties increased autonomy over the terms of their agreements. Nonetheless, the Amended ECL continues to include a number of implied terms, many of which are surprisingly detailed. For example, several articles specify duties for particular types of contracts, including contracts for construction projects, processing goods, electricity supply and consumption, storage and custody, and property insurance.

The Amended ECL also retains detailed rules for particular types of breaches. For example, Article 33 (formerly Article 38) specifies that the buyer shall bear the additional expenses incurred if it misinforms the buyer of the destination for the goods, or changes it without providing sufficient notice. Article 35 (formerly Article 40) provides that if the party to a contract for processing fails to collect the goods on time, it shall be liable for storage fees. These detailed provisions may have provided useful standard procedures when economic contracts were used primarily to implement state production plans. But they are less likely to be required by private parties, who will no doubt want to develop their own standard form contracts. Nonetheless, the Amended ECL retains most of these detailed provisions.[30] It is not clear from the ECL itself whether parties can override terms implied by the ECL by including their own conflicting terms in the written agreement. If they are not permitted to do so, then the detailed terms contained in the ECL could become an unfortunate barrier to party autonomy.

Amendment, termination and excuses for non-performance

The amendments to the ECL significantly increase the parties' freedom to amend or terminate their agreement. Under Article 27(1) of the 1981 ECL,

[30] The provision relating to scientific and technological co-operation contracts (Article 26 of the 1981 ECL) was deleted, as these contracts have been governed by a separate law since 1987. See Law on Technology Contracts of the People's Republic of China, adopted at the 21st Session of the Standing Committee of the Sixth National People's Congress, 23 June 1987, published in *China Laws for Foreign Business: Business Regulation* (note 1 above), Vol 1, paras 5-577(6)–(55), and in Cohen (note 1 above) at pp 150–8.

parties were permitted only to amend or terminate a contract if doing so would 'not harm the interests of the State or affect the implementation of State plans.' The revised version of this article (now numbered Article 26(1)) makes no reference to state plans. The drafters have also deleted Article 29 of the 1981 ECL, which previously required that any amendment or termination of a contract involving products prescribed in a mandatory state plan could be signed only after it had been submitted for approval by the department in charge of the plan. Article 30 (regarding the timing of requests to amend or terminate contracts and the replies thereto) has also been deleted.

Interestingly, unlike Article 11 (regarding the formation of contracts implementing mandatory state plans, discussed above), Article 26 of the Amended ECL does not qualify the autonomy of the parties to amend or terminate contracts with any reference to 'administrative regulations.' The only express limitation on them is a general requirement that the amendment or termination must not 'harm State or public interest.' However, if a party were compelled by an administrative regulation issued pursuant to Article 11 (discussed above) to enter into a contract implementing a mandatory state plan, it is highly likely that any attempt to terminate or significantly amend that contract would be interpreted as harming the state or public interest. Any other interpretation of Article 26 would appear to defeat the purpose of the reference to 'administrative regulations' in Article 11.

In addition to giving parties increased freedom to change their contracts, the amendments to the ECL should give parties increased certainty that their agreements will not be altered without their consent. The drafters have deleted two of the grounds upon which a contract formed under the original ECL could be amended or terminated *without* the agreement of both parties. These were Article 27(2), which permitted amendment or termination in the event that the state plan on which the economic contract was based was revised or terminated, and Article 27(3), which permitted amendment or termination in the event that one of the parties could not perform because it had closed down, suspended production, or changed its production orientation. These changes are in line with the policy of increased responsibility of enterprises and with the assumption that the ECL will increasingly be used to form truly voluntary contracts (as opposed to mere administrative orders to carry out state plans).

The ECL now provides (in Article 26(2) and (3)) only two instances in which a contract can be considered amended or terminated without the consent of both parties: (1) where force majeure can be shown; and (2) where 'the other party has failed to perform the contract within the time limit prescribed in the contract.' It is unfortunate that the ECL continues to address these two situations under the heading of 'amendment and dissolution' of the contract, as that is not necessarily an accurate definition of their effect. By stating that these are grounds for considering the contract amended or

terminated, the ECL implies that these two grounds automatically modify or eliminate the parties' obligations and potential liabilities. But, in fact, this may not be the case, as indicated by the second paragraph of Article 26. This paragraph begins by stating that:

> If the instances [force majeure or breach of contract] apply, one of the parties concerned shall have the right to notify the other party to dissolve the contract.

But the sentence immediately following stipulates:

> In a case where one of the parties incurs losses due to the amendment or dissolution of the economic contract, the party responsible shall bear liability for compensation, except in those cases which are excluded from liability in accordance with the law.

This implies that the mere fact that a contract is deemed to have been 'amended or dissolved' pursuant to Article 26 does not necessarily modify or terminate the original liabilities under that contract. Rather, we must examine whether the party responsible for the amendment or dissolution can be excused from liability 'in accordance with the law.'

Unfortunately, there is no guidance in Article 26 as to when the party will be so excused. Clearly, where both parties *agree* to amend or dissolve the contract, one party cannot claim compensation from the other for any resulting losses. But what if it is an event of 'force majeure' that is considered to have amended or dissolved the contract? Of course, parties may include a specific clause stating that particular events of force majeure will excuse the non-performing party from liability. However, if they do not include such a clause, the non-performing party may nonetheless allege (pursuant to Article 26(2)) that the contract has been 'amended or dissolved' as a result of force majeure. But that only begs the real question, as Article 26 would appear to leave open the possibility for the party that proves force majeure still to be held liable for the other party's losses.

The only other provision addressing the issue of force majeure (Article 30 of the Amended ECL) is also very vague, although it indicates that a party that proves force majeure should receive at least some reduction in its liability for non-performance. Article 30 states that if a party provides evidence of force majeure:

> [P]ostponement of implementation of the contract or part of the contract or forgoing of implementation of the contract may be allowed. The party may also be partially or completely exempted from being liable for breach of the contract.

The General Principles of Civil Law also briefly addresses force majeure, stating simply that: 'Where because of force majeure it is impossible to perform a contract ... there is no civil liability unless the law provides otherwise.'[31] Of course, this really only returns us to the question of whether the relevant law (Articles 26(2) and 30 of the Amended ECL) does 'provide otherwise.'[32]

The ECL is even more cryptic with respect to the other ground on which the contract may be considered amended or terminated without the consent of both parties—where one party breaches the contract. In the 1981 ECL, Article 27(5) stated that amendment or termination was allowed when a breach by one party made implementation of the contract 'unnecessary.' This could be interpreted as meaning that any breach would make it unnecessary for the innocent party to perform and therefore 'amended or terminated' the contract. But it could just as easily be interpreted to mean that (as under the common law and the contract laws of many Continental countries) only major breaches have this effect.[33]

The 1981 ECL gave parties some limited additional guidance on this issue, at least with regard to contracts for the sale of goods. Article 37 originally provided that no party could withhold delivery of goods (detain goods as 'mortgages') or withhold payments as an offset. This provision was probably included to ensure that materials necessary for producing goods mandated in the state production plans were not withheld due to the failure of an enterprise to pay for the materials. However, this language has been deleted from the article (now numbered Article 32). Thus, there is now no specific rule against refusing to deliver goods on the ground that the other party has fallen behind in its payments. On the other hand, there is also no guidance as to whether doing so will be considered a breach of contract.

Indeed, the Amended ECL provides no firm guidance as to when a party may refuse to perform on the ground that the other party has breached its obligations. Article 26(3) simply allows the 'amendment or dissolution' of the contract in the event that one party 'fails to implement the contract within the time limit prescribed in the contract.' Does this mean that *any* failure to perform on time (such as insufficient quantity or quality of goods) gives the other party the right to treat the contract as 'dissolved' and cease performance? Or does only a significant breach of contract have this effect?

31 GPCL (note 16 above), Art 107.

32 It has been noted that '[i]t took China a long time to agree that a contract may be discharged by force majeure' and that under Chinese law the concept is 'different from that in common law countries' and 'not absolute': Wang Guiguo (note 18 above), p 122. Interestingly, in each of the domestic contract cases cited by Wang Guiguo as examples of instances in which force majeure has been alleged, the dispute was resolved by 'mediation' by the court and the parties were obliged to share the losses. Ibid, pp 122–7.

33 Regarding the rules under English law (which are also applicable in Hong Kong), see M P Furmston, *Cheshire, Fifoot and Furmston's Law of Contract* (London: Butterworths, 12th ed 1991), p 539. Many Continental countries have a similar principle that only a major breach permits the other party to refuse to perform. See Whincup (note 22 above) pp 106–13.

Moreover, even if the non-breaching party can be certain that it has the right not to perform under Article 26(3), it cannot be certain as to whether it can fail to perform and still preserve its right to sue for damages. Under the common law, in the event of a major breach (a breach of a 'condition' of the contract), the innocent party may repudiate the contract and cease performance, but can still sue for damages under the contract.[34] It is unclear whether this is the case under Article 26 of the Amended ECL. If the contract is truly 'dissolved' by the innocent party's decision to cease performance in light of the other party's breach, it may be that there is no longer any contractual liability by either party. Yet, the second paragraph of Article 26 leaves this issue open, stating that the responsible party may be liable to compensate the other party for losses resulting from the amendment or dissolution unless it can be 'excused from liability under the law,' but providing no guidance as to *when* the responsible party will be so excused.

This ambiguity, which will make it very difficult for a private party to decide how to respond to a breach by the other party, should have been addressed by the drafters. The confusion has been caused in part by the decision to continue to group together several very different concepts, without providing any separate discussion of their consequences. Fundamental breach, force majeure, and other excuses for non-performance should not be grouped together with voluntary amendment and termination of the contract, but rather should be treated separately, with the consequences for liability clearly specified.

There are many other important issues that are not even addressed in the ECL. In some cases, the General Principles of Civil Law has filled in the gap. For example the GPCL contains provisions relating to vitiating factors[35] and the Supreme Court's official interpretation of the GPCL further elaborates on such factors and the remedies available for them.[36] However, with regard to other issues (such as the question of whether breach discharges the non-breaching party, discussed above), the GPCL offers little additional guidance. For example, Article 111 of the GPCL provides that when one party fails to perform, the other party has the right to demand performance and seek compensation for loss. But it does not state whether the breach entitles the innocent party to refuse to perform, and if so, whether it could do so while still preserving its right to sue for damages.

It is understandable that the 1981 ECL would have had such gaps. Ambiguities in the rights of parties are less significant where contracts are viewed as administrative orders (and authorities are likely to settle disputes by simply

[34] Furmston (note 33 above), p 545.
[35] See, eg, GPCL (note 16 above), Art 58(3) (fraud and duress) and Art 59 (mistake).
[36] See, eg, paras 68–73 of the 'Views of the Supreme People's Court on Questions Concerning the Enforcement of the "General Principles of the Civil Law of the PRC" (Trial Implementation),' 26 January 1988, published in Chinese and English in China Law & Practice, 20 February 1989, pp 55–6.

issuing further administrative orders). But as the ECL is increasingly used for truly 'private' transactions, greater guidance and legal certainty is required. It is unfortunate that the drafters of the amendments to the ECL did not take the opportunity to make the ECL more comprehensive and detailed. The remaining gaps in the ECL are particularly ironic in view of its many implied terms (discussed above) for particular types of contracts. Thus although the ECL has many unnecessarily detailed provisions, it fails to provide some of the more general and fundamental principles required by China's expanding private economy.

Enforcement of economic contracts and remedies

Traditionally, the first step in any contractual dispute in China has been mediation. While mediation is officially a voluntary process, in practice so much pressure is put upon the parties to resolve their dispute that the process has often operated more like a compulsory settlement. Article 48 of the original ECL reflected this emphasis, providing that parties should promptly settle any dispute through consultation. Only if an agreement could not be reached could a party commence arbitration or an action in the courts. Even then, the parties would likely be required, either by the arbitration authority or by the court, to participate in further mediation sessions.[37] However, the amendments to the ECL appear to decrease somewhat the importance of mediation. The amended version of Article 48 (now numbered Article 42) no longer states that parties 'should' resolve their dispute through mediation or consultation, but rather that they 'may' do so. Moreover, the new Article 42 makes clear that if parties are unwilling even to try mediation, they may immediately commence an enforcement proceeding. These changes are consistent with the recent amendments to the civil procedure law and are to be welcomed. Compulsory mediation can significantly hinder a party's efforts to enforce the contract, especially in cases where the breach is clear and the breaching party has a strong incentive to drag out the mediation process, thereby delaying any real enforcement of its obligations. Indeed, it has been argued that mediation in China 'has become a synonym for stalling tactics' and that it wastes resources and hinders economic development.[38]

In addition to reducing somewhat the emphasis upon mediation, the amendments also have the potential to increase the role of arbitration in

[37] See, eg, the study of cases by David Zweig, Kathy Hartford, James Feinerman, and Deng Jianxu, 'Law, Contracts, and Economic Modernization: Lessons from the Recent Chinese Rural Reforms' (1987) 23 Stanford Journal of International Law 319. The cases indicated that courts 'doggedly' try to mediate disputes, and that '[u]ntil the very moment that a judgment is announced, the legal system encourages out-of-court settlements.' Ibid, p 357.

[38] Fu Hualing, 'Understanding People's Mediation in Post-Mao China' (1992) 6 Journal of Chinese Law 211, 221.

contractual disputes. Article 48 of the 1981 ECL stated that if mediation failed, a party could either apply for arbitration or initiate a suit in the people's court. There was no express limitation upon the jurisdiction of the court, even where the contract provided for binding arbitration. Moreover, under Article 49 of the original ECL, even where an arbitration decision had been issued, if one or both of the parties were not satisfied with the arbitration, they had fifteen days in which to initiate a suit in the people's court.

The amendments to the ECL increase significantly the power of arbitration clauses and decisions. First, the amended version of Article 48 (now numbered Article 42) provides that parties may initiate an action in court *only* if the contract contains no arbitration clause and the parties have not subsequently agreed to arbitrate the dispute. The provision giving parties the right to appeal the arbitration decision within 15 days has also been deleted. The drafters have also added language (to the amended Article 42) stating that if an arbitration decision is not complied with, a party may request the people's courts to enforce it. Of course, the impact of these changes depends largely on the effectiveness and integrity of the arbitration process and upon the parties' perceptions of it. If parties do not have confidence in the arbitration process, they will still have the option not to agree to arbitrate, thereby preserving their right to initiate an action in the courts.

The main provision regarding the remedies for breach of contract has not been changed (other than to renumber it from Article 35 to Article 31). Article 31 continues to mandate that the breaching party pay a breach of contract penalty ('breach fees') to the other party, as well as compensation for any losses beyond the amount of the penalty. It also continues to provide for specific performance, stating that if a party demands continuous performance of the contract, the party in breach shall continue to perform.

It is interesting that the drafters chose to retain this emphasis upon penalty clauses and specific performance. Under the 1981 ECL, these remedies were considered important tools in ensuring that economic contracts were performed and state production targets fulfilled. For example, Gu Ming noted that while capitalist countries normally prefer damages as the remedy, '[w]e stress actual performance to ensure the implementation of the state plan'.[39] But given the purported reduced significance of state plans under the amended ECL, it is surprising that the drafters did not see fit to amend Article 31 so as to make monetary damages the normal remedy.

The one change to contractual remedies that does reflect the new conception of economic contracts is the deletion of Article 33, which provided for indemnification of a party held liable for breach of contract where the breach was actually caused by the fault of higher authorities or the department in charge of the party. Thus enterprises will be expected to bear full responsibility

[39] Gu Ming (note 7 above), p 55.

for their liabilities. This is a sensible amendment, so long as enterprises are given autonomy when deciding whether or not to enter a contract, and in negotiating its terms. However, the amendment raises the question of what will occur if an enterprise is compelled by 'administrative regulations' issued pursuant to Article 11 (discussed above) to enter into a contract that it cannot perform. When the enterprise breaches that contract, will the administrative authorities assist it with its liabilities? The deletion of Article 33 indicates that they will no longer be obligated to do so.

Conclusion

Any assessment of the effectiveness of the amendments to the ECL depends largely upon their underlying purpose. If the goal of the amendments was to create the appearance of reducing official intervention in economic contracts while preserving the power to intervene, then the amendments may be quite effective. On the other hand, if the drafters were hoping to give economic actors true autonomy (and the confidence that their autonomy will be preserved), then the Amended ECL falls well short of the goal. Although many of the amendments do give the private parties greater contractual freedom, far too much continues to turn upon 'administrative regulations' and therefore upon the current policies of the state. Ironically, when the 1981 ECL was enacted, it was hoped that because the ECL was a law (and not a mere policy or regulation) it would give the reformist policies greater permanence and would 'insulate them from policy reversals.'[40] But the decision of the drafters of the Amended ECL to leave very significant issues to 'administrative regulations' obviously reduces the value of that advantage.

Finally, even where parties are permitted to transact without governmental interference, the failure of the drafters to fill in the many gaps in the ECL will leave the parties with insufficient guidance as to their rights and obligations. This failure reveals the inherent difficulty in using a law that was originally drafted as a 'tool of the state plan' as the basis for a general law of contract for private parties. The end result is a law that is very (and often unnecessarily) detailed in some areas, yet hopelessly vague in others. A better approach would have been to start afresh, perhaps with the Foreign Economic Contract Law as a guide (with the eventual aim of unifying the law of domestic and foreign contracts). Unfortunately, it appears that this approach is still not politically acceptable in China. Thus, for the present time, the amended ECL may represent the best 'compromise' law of contract that can be achieved.

*Carole J Petersen**

[40] Potter (note 2 above), p 43.

* Lecturer in Law, School of Professional and Continuing Education, University of Hong Kong.