

RECENT DEVELOPMENTS IN CHINESE CONTRACT LAW

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INTRODUCTION

Contracts were legal forms of commodity exchange in the People's Republic of China (PRC). Contract regulations were developed to guarantee the implementation of state plans. They set out some basic principles and contained provisions relating to the signing, performance and responsibilities for breach of contract.¹

In 1979, China began to open itself up to the outside world. Insisting on a planned economy, the central government greatly encouraged the development of the socialist commodity production and exchange. The drafting of a modern *economic contract* law based on the planned economy began in October 1980. Following the 3rd session of the 5th National People's Congress, the Economic Contract Law (ECL) of the PRC was promulgated on 13 December 1981.²

The 1981 Economic Contract Law (ECL) consisted of 7 chapters with 57 articles. It came into force on 1 July 1982. The content breakdown was as follows:

Chapter 1	(8 articles)	General Provisions
Chapter II	(18 articles)	Conclusion and Performance of Economic Contracts
Chapter III	(5 articles)	Modification and Rescission of Economic Contracts

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¹ RM Pfeffer, *Understanding Business Contracts in China*, Harvard University Press, 1949-1963; GT Hsiao, "The Role of Economic Contracts in Communist China" 53 *California Law Review* 1029-1060.

² For an English translation of the ECL see J Cohen, *Contract Laws of the PRC*, Longman, 1988 at 49-61.

Chapter IV	(16 articles)	Liability for Breach of an Economic Contract
Chapter V	(3 articles)	Mediation and Arbitration of Economic Contract Disputes
Chapter VI	(3 articles)	Administration of Economic Contracts
Chapter VII	(4 articles)	Supplementary Provisions

The ECL set out some basic principles relating to the domestic economic contract.³ It should be noted that there is no specific legislation governing contracts entered into between two *individuals*. Although Article 56 provided that relevant government departments of the State Council and the people's government of the provinces, municipalities and autonomous regions might formulate implementing regulations, detailed implementing regulations have not been promulgated to date.

Article 55 of the ECL provided "regulations on economic and trade contracts involving foreign interests shall be enacted with reference to the principles of the ECL and international practice." Pursuant to this article, the Standing Committee of the National People's Congress promulgated the Foreign Economic Contract Law of the People's Republic of China (FECL) on 21 March 1985.⁴ The FECL applies to economic contracts concluded between PRC enterprises or other economic organisations, foreign enterprises and other foreign economic organisations or *individuals*, with the exception of international transport contracts (Art 2 FECL), which are regulated by the Maritime Code of the PRC.⁵

Initially, technology contracts were regulated by the ECL, but separate legislation on technology contracts was enacted in 1987.⁶ The law relating to marine insurance contracts is now set out in the Maritime Code⁷ and

³ The ECL does not define an economic contract. But Art 2 provided that "economic contracts are agreements between legal persons for the purpose of realising certain economic goals and clarifying each other's rights and obligations."

⁴ For an English translation of the FECL see Cohen, n2 at 165-169.

⁵ Adopted at the 28th session of the Standing Committee of the 7th National People's Congress on 7 November 1992, effective 1 July 1993. For an English Translation of and comment on the Maritime Code, see *China Law & Practice* (CLP), 25 February 1993 at 19-48.

⁶ On 23 June 1987, the PRC Technology Contract Law was adopted at the 21st session of the Standing Committee of the 6th National People's Congress. For an English translation of the PRC Technology Contract Law see Cohen, n2 at 150-160.

⁷ n5.

non-marine insurance contracts are governed by the PRC Insurance Law.⁸ Contracts relating to the provision of securities such as mortgages and guarantees are governed by the PRC Law of Securities.⁹ There are some provisions relating to contract in the PRC General Principles of Civil Law (GPCL) adopted at the 4th session of the 6th National People's Congress, effective on 1 January 1987.¹⁰

The ECL and FECL are two very important pieces of nation-wide *economic contract* legislation. In addition, "[t]here are dozens of administrative regulations made by the State Council and its subsidiary commissions and ministries. There are also numerous regulations, decrees and rules made by local authorities. On top of all these, the Supreme Court and various administrative commissions and ministries frequently issue opinions, orders and instructions that are of norm-creating character. The complexity of this normative structure is worsened by the fact that unpublished rules are often invoked by the authorities as the controlling norm".¹¹

The ECL governed economic contracts between Chinese legal persons (Art 2). However, it also provided that economic contracts signed between self-employed individuals or rural commune members and legal persons should be carried out with reference to the ECL (Art 54).

The ECL was enacted at the time when China had just begun its economic reform. It was formulated on the basis of state plans and state policies, and was meant to assist in the development of the socialist planned commodity economy. But the economic reforms over the past ten years have brought about significant changes in China's economic structure. Although the publicly owned economic sector is still the mainstay of the

⁸ Adopted at the 14th session of the Standing Committee of the 8th National People's Congress on 30 June 1995 and effective from 1 October 1995. For an English translation of, and brief comment on the Insurance Law, see (1995) 8 *CLP* 16. For information on insurance contracts in China see (1997) *IJIL* 120.

⁹ Adopted at the 14th session of the Standing Committee of the 8th National People's Congress and promulgated on 30 June 1995, effective 1 October 1995. For an English translation of, and brief comment on the Law of Securities, see (1995) 11 *CLP* 21; also China Laws for Foreign Business - Business Regulation, CCH at 5-605.

¹⁰ For an English translation of the GPCL, see Cohen, n2 at 29-48. For a detailed discussion of the GPCL, see H Zheng, *China's Civil and Commercial Law*, Butterworths, 1988 at 19-44.

¹¹ Wang & Wei (eds), *Legal Developments in China: Market Economy and Law*, Sweet & Maxwell, 1996 at 235.

economy, various other economic sectors are becoming more and more important. "The economic restructuring in the rural areas continues to develop in depth; State-owned enterprises are shifting to new management mechanisms; the role of the market in the distribution of resources is rapidly expanding; economic and technological exchanges and co-operation with other countries are conducted widely; and the structure of planned economy is gradually being replaced by the socialist market economic structure."¹² In 1993, China amended its Constitution.¹³ The amended Art 15 of the Constitution provides that "the State practises a socialist market economy. The State strengthens economic legislation and perfects macro-level regulation and control."¹⁴

Economic reforms in China over the past ten years have made some of the provisions in the 1981 ECL irrelevant and outdated. In July 1990, the State Administration of Industry and Commerce and the State Commission for Restructuring the Economic System jointly submitted to the State Council a draft amendment to the ECL. The Legislative Affairs Bureau of the State Council sent out some 80 copies of the draft to relevant central government departments, specialized companies, banks, courts, local governments and legal experts for their comments and opinions. It also held four large scale conferences to discuss the provisions in the draft, which subsequently underwent seven major revisions before it was submitted to the Standing Committee of the National People's Congress for consideration. It was adopted on 2 September 1993 by the Standing Committee of the 8th National People's Congress.¹⁵ The amendment is a temporary measure pending the drafting of a contract Code. The following paragraphs will discuss the principal changes to the 1981 ECL.¹⁶

¹² "Decision of the Chinese Communist Party Central Committee on issues concerning the establishment of a socialist market economic structure (14 November, 1993)", *China Economic News*, 29 November 1993, Supplement No. 12.

¹³ On 29 March 1993, the 8th National People's Congress adopted a set of amendments to the 1982 Constitution. See 23(2) *Hong Kong Law Journal* at 224-229.

¹⁴ Prior to the amendment, the article read: "The State practises economic planning on the basis of socialist public ownership. The State ensures the proportionate and co-ordinated development of the national economy through overall balancing by economic planning and the supplementary role of market regulation. Disruption of the socialist economic order or undermining of the State economic plan by any organization or individual is prohibited."

¹⁵ See the explanations by the Director of the Legislative Affairs Bureau of the State Council concerning the revised draft of the ECL of the People's Republic of China included in a booklet published in Chinese entitled *The PRC Economic Contract Law*, Chinese Commercial Publishing House, Beijing, September 1993 at 27-34.

¹⁶ (1993) 11 *CLP* 40.

PARTIES TO CONTRACT

The ECL applied to economic contracts concluded between legal persons (Art 2).¹⁷ It also provided that economic contracts entered into between individual industrialists and merchants, rural commune members and legal persons should be implemented with reference to the ECL (Art 54). Article 2 has now been amended to read that the ECL applies to contracts between legal persons, other economic organisations, individual industrialists and merchants and rural business contractors that are equal civil legal subjects. It seems that the revision is only cosmetic and there is no substantive change in the law and practice.

LEGAL BASIS OF THE CURRENT ECL

The ECL was formulated on the basis of the planned economy, and contracts were used to implement the economic plan. "A typical procedure is for a planning authority to issue production or delivery or distribution orders, requiring a manufacturing unit to acquire certain raw materials, process them, and deliver the product as directed. These orders create obligations binding in administrative law on the enterprises to which they are directed. The enterprises then enter into contracts, which create civil law rights and duties, as a method of performing these obligations. The plan predetermines in lesser or greater detail the contents of the contracts, and the extent of freedom of contract enjoyed by the various enterprises fluctuates accordingly."¹⁸

The amended ECL is based on the current Chinese policy of practicing the "socialist market economy". There is no clear definition of "socialist market economy" either in the Constitution or in the amended ECL. It is obvious that under the socialist market economy it is the market and not the state plan that plays a fundamental role in resource allocations under

¹⁷ A legal person must satisfy the following conditions:

1. It must be established in accordance with law;
2. It must possess the necessary property or funds;
3. It must possess its own name, organisational structure and premises;
4. It must be able to assume civil obligations independently (Art 37 GPCL).

¹⁸ DE Allen & ME Hiscock, *Law of Contract in Australia*, 2nd ed, CCH, Australia, 1992 at 26.

macro-economic control by the state. It is said that “in the contemporary Chinese jurisprudential literature the market economy is almost invariably associated with the positive values of the rule of law, freedom, autonomy, equality, democracy, human rights and human flourishing, and the planned economy with arbitrary power, bureaucratic privilege, unquestioning obedience to commands of superiors, and lack of freedom, initiative and creativity.”¹⁹

In line with the current economic policy, the amended ECL has stripped itself of most of the references in the original ECL to state plans as the basis for contract activities;²⁰ parties to a contract need to comply with laws and administrative regulations only and not the state plans (Art 4).²¹

FREEDOM OF CONTRACT

The amended ECL has given the parties more contractual freedom. The original ECL provided, among other things, that the terms relating to the quantity of goods should be concluded in accordance with the plans approved by the state or the higher-level department in charge; the terms relating to the quality of goods and packaging quality should follow the state standards or specialised standards or standards set by the department in charge; and that the price of goods should be fixed in accordance with the price stipulated by the departments in charge of price control at various levels (Art 17). The amended Art 17 reads as follows:

The terms regarding the quantity, quality, packaging quality and prices of products and the time limit for their delivery in purchase and sale contracts (including contracts for supply, procurement, advance purchase, combination and coordination in purchases and sales, and adjustment) shall be implemented in accordance with the following provisions:

¹⁹ A Chen in Wang & Wei, n11 at 13.

²⁰ (1993) 11 CLP 40 at 46.

²¹ There are still some provisions in the amended ECL which refer to the state plan. For example, there are references to mandatory plans in Art 11, and Art 18 provides, among other things, that contracts for the undertaking of major construction projects of the state shall be signed in accordance with the procedures prescribed by the state and documents such as investment plans, planning project descriptions, etc. approved by the state.

1. Product quantity shall be stipulated by the seller and the buyer after consultation. Product quantity shall be measured in accordance with state regulations or, in the absence of state regulations, in accordance with the method agreed upon by the seller and the buyer.
2. Stipulated product quality requirements and packaging quality requirements should not be less stringent than mandatory state or mandatory industry standards, if such standards exist. In the absence of both mandatory state and mandatory industry standards, the said requirements shall be stipulated by the parties following consultations.
3. Price of products shall be set by the parties through consultations, except for products for which the state has prescribed that prices set by the state be adopted. If prices set by the state are adopted and state prices are adjusted within the time limit for delivery specified in the contract, the prices shall be calculated according to prices prevailing at the time of delivery. If delivery is made after expiration of the time limit, the original prices shall be adopted if prices have increased, and the new prices shall be adopted if prices have fallen. If delivery of the goods is taken or payment is made after expiration of the time limit, the new prices shall be adopted if prices have increased, and the original prices shall be adopted if prices have fallen.
4. The time limit for delivery (or taking delivery) of the goods shall be carried out in accordance with the stipulations in the contract. If any party requests advancement or extension of the time limit for delivery (or taking delivery) of the goods, it shall reach an agreement with the other party beforehand and then implement it accordingly.

CONTRACT ADMINISTRATION AUTHORITIES

Under the original ECL, the contract administration authorities²² were

²² That is, the Industrial and Commercial Administration Bureau (ICAB). The State ICAR is a body directly under the State Council.

empowered to mediate or arbitrate for contractual disputes and to confirm that an economic contract was or was not void (Arts 7 & 48). This power has been removed by the amendment and the invalidity of an economic contract shall be confirmed by a people's court or an arbitration organisation (Art 7).

SEPARATION OF ENTERPRISES FROM ADMINISTRATION

The state organs used to lead and organize economic construction. The functions of government were not separated from those of enterprises which were appendages of administrative organs. Thus, variation and termination of contract in certain circumstances required the approval of the department in charge of the parties (Art 29), and if an economic contract could not be performed or could not be fully performed because of the fault of higher-level leading authorities or the department in charge of the parties, the latter would bear liability for breach of contract (Art 32).²³

In 1984, the Central Committee of the Communist Party of China was of the opinion that there was a pressing need to conduct reform in line with the principle of separating the functions of government and enterprises, streamlining administration and instituting decentralization in order to invigorate the enterprises and the national economy as a whole.²⁴ Consequently, articles 29 and 32 were repealed by the 1993 amendment.

THE PROPOSED CONTRACT CODE

Soon after the revision of the ECL in 1993, the Legislative Affairs Commission of the Standing Committee of the National People's Congress held a conference in Beijing, inviting experts and scholars to give opinions on the proposed nationwide uniform contract Code. In 1994, the Legislative Affairs Commission entrusted the drafting of a contract Code to a group of

²³ Arts 29 & 32 were repealed by the 1993 amendment.

²⁴ *Decision of the Central Committee of the Communist Party of China on Reform of the Economic Structure*, adopted by the 12th Central Committee of the Communist Party of China at its Third Plenary Session on 20 October, Hong Kong, Joint Publishing Co, 1984.

academics teaching in various universities in China. The first draft was sent to the Legislative Affairs Commission for consideration in January 1995.²⁵

REASONS FOR THE CODE

The main reasons for the proposed Code can be summarized as follows:²⁶

1. The existing contract legislation which reflects the planned economy and not then current socialist market economy is outdated.
2. The existing contract legislation contains provisions which are inconsistent with each other.
3. The existing contract legislation was based on the outdated Chinese civil law concepts formulated in the 1950s, which in turn, were based on the former Soviet law.²⁷ Some of the concepts, such as the distinction between economic contracts and civil contracts, and the idea that contracts can only be entered into by entities and not individuals,²⁸ are outdated.
4. The existing contract legislation simply sets out some general principles and there are no detailed provisions.

GUIDELINES FOR THE CODE

In drafting the Code, the drafters bore in mind the following five guidelines:²⁹

²⁵ L Huixing (ed), (1995) 4 *Commercial Law Review* at 3.

²⁶ (1995) 3 *Chinese Legal Science* 9 at 10-11.

²⁷ Such as the distinction between economic contracts and civil contracts and the concept that contracts could only be entered into by entities and not individuals.

²⁸ But note Art 2 of the Technology Contract Law which provides that "This Law applies to contracts concluded between legal persons, between legal persons and citizens, and between citizens, establishing civil relationships of rights and obligations with respect to the development of technology, technology transfer, technical consultation and technical services, not including those contracts to which a foreign enterprise, other organisation or individual is a party."

²⁹ Huixing, n25 at 12-13.

1. Take into consideration the open-door policy, current economic reform and the practice of the socialist market economy, the current contract legislation, experience in judicial practice, the legal system of the developed countries and international conventions and practice.
2. Protect the individual's freedom of contract to ensure that this freedom will not be interfered with by administrative organs and other associations.
3. Make provisions for the transition from the planned economy to the socialist market economy and to ensure that the provisions in the Code meet with the requirements of the socialist market economy.
4. Increase efficiency, promote production and maintain social justice to protect the rights of the consumers and the working class.
5. Consider the legal norms and their enforceability to ensure that the legal concepts, areas of application and provisions are clear.

CONTENTS OF THE CODE

The Code has 34 chapters and 528 articles. Articles 1-164 cover the general principles of contract. Articles 165-525 contain provisions on specific contracts such as sale and purchase of goods, loan agreements, carriage of goods, guarantees and insurance contracts. Chapter 34 contains supplementary provisions on the application of the Code to contracts involving foreign individuals or entities, transitional provisions and the date of commencement of the Code.

When the Code comes into force, it will repeal the ECL, FECL and Technology Contract Law (Art 528). Although it is silent, presumably, the Code applies to contracts concluded between Chinese citizens, Chinese legal entities and associations. It does not make any distinctions between economic contracts and other contracts. The Code also applies to contracts entered into between Chinese citizens, legal entities, and other organisations, with foreign citizens, legal entities and other organisations (Art 526).

THE CODE'S BASIC PRINCIPLES

Chapter 1 of the Code sets out the general provisions applicable to contracts. A contract is defined as an agreement whereby parties establish, modify or terminate their relationships of obligations and rights (Art 2).³⁰

The basic principles governing civil activities set out in the GPCL are different from those set out in the Code. Because the Code is specific legislation, it seems that the provisions in the Code will prevail over the relevant provisions in the GPCL.

Article 4 of the GPCL provides that civil activities must be carried out in accordance with the principles of voluntariness, fairness, exchange of equivalent values, honesty and good faith. The Code retains the principles of fairness, honesty and good faith, but omits the principles of voluntariness and exchange of equivalent values. It should be noted that the principle of exchange of equivalent values was removed from the original ECL in the 1993 amendment, probably to reflect the practice of the socialist market economy. The Code sets out the following five basic principles:

1. The Principle of Freedom of Contract

The parties enjoy freedom of contract as allowed by law, which should not be interfered with by any organ, association or individual (Art 3).

2. The Principle of Equality

The legal position of the parties is equal; neither party can impose his will on the other (Art 4).

3. The Principle of Fairness

The confirmation of the content of a contract should follow the principle of fairness (Art 5, para 1). If the confirmation is by a contractual party or a third party, it will become effective only if the confirmation follows the principle of fairness (Art 5, para 2).

4. The Principle of Honesty and Good Faith

The exercise of rights and the performance of obligations by the parties should follow the principle of honesty and good faith (Art

³⁰ Cf Art 85 GPCL which provides that a contract is an agreement whereby parties establish, modify or terminate civil relationships.

6, para 1). When a court tries a case, which is not governed by any statutory provisions, or which is governed by a provision or provisions, but the application of which will obviously go against social righteousness, it may directly apply the principle of honesty and good faith (Art 6, para 2). When a court applies the principle of honesty and good faith in the trial of a case, it should have the approval of the Supreme People's court (Art 6, para 3).

5. The Principle of Public Order and Good Custom

The content and purpose of the contract should not contravene public order or good custom (Art 7).

The proposed Code does not define "freedom of contract". With the phasing out of the planned economy and the emergence of the socialist market economy, it is likely that the central government will avoid placing restrictions on the competence and authority of state-owned enterprises to contract. But it is pertinent to ask to what extent one party is free to decide on the person with whom to contract, and the form and content of a contract. Other relevant issues are whether the contract involves a key project, and whether or not approval of the relevant government ministry or ministries may still be required for the contract to be valid.

The principle of equality may raise a number of issues. If a party to a transaction is under a special disability or disadvantage in dealing with the other party because of illness, ignorance, inexperience, impaired faculties, financial need or other similar circumstances, will the contract become void or voidable because of the inequality of parties' legal position? Is Article 4 concerned with the situation where one party, using his authority, exerts some pressure on the other to enter into a contract?

It is difficult to decide whether or not the content of a contract is fair. The Code does not set out any guidelines for this. Chinese law does not have as one of the sources of law something similar to the English "rules of equity" or the principle of unconscionability as expounded in the case of *Commercial Bank of Australia Ltd v. Amadio*.³¹ Generally, it is the court or an arbitral body that confirms whether or not the content of the contract is fair. Thus the meaning of Art 5, para 2 is unclear.

³¹ (1983) 151 CLR 447.

Although Article 6 says the exercise of rights and the performance of obligations by the parties should follow the principle of honesty and good faith,³² the principle has a much wider application. It also applies to pre-contractual negotiations.³³ If, in the process of negotiation, one party acquires confidential information from the other party, the former is legally obliged not to disclose it to any other person or not to improperly use it (Art 30). In this respect, Chinese contract law closely follows the civil law concept.³⁴ Honesty and good faith embrace the following principles³⁵

1. A party to a contract should not commit any dishonest act to induce the other party to enter into the contract. Dishonest acts include misrepresentation and concealment of material facts.
2. During the performance of the contract, a party that cannot perform his obligations under the contract as a result of *force majeure* should inform the other party promptly to minimise the loss, if any. Unless the law provides otherwise, if a party wants to vary or cancel the contract, he should consult the other party first and obtain the other party's consent.
3. If the terms of the contract are not clear, they should be interpreted on the basis of honesty and good faith. No party should deliberately twist the meaning of a contractual term.
4. The contract should not contain any term that will restrict competition and maintain monopoly.³⁶

³² Art 64 says a contract should be carried out in accordance with its nature, trade practice and the principle of honesty and good faith. Further, Art 65 provides that parties should join in a common effort in the performance of the contract.

³³ Art 29.

³⁴ On the civil law principle of honesty and good faith, see B Nicholas, *The French Law of Contract*, 2nd ed, Oxford, Clarendon Press, 1992 at 48, 71, 153-4.

³⁵ *Handbook of Chinese Contract*, Beijing, Economics & Management Publishing House, 1991 at 21-22.

³⁶ Cf Art 35 PRC Technology Contract Law, adopted at the 21st session of the Standing Committee of the 6th National People's Congress on 23 June 1987. For an English translation of the PRC Technology Contract Law, see Cohen, n2 at 150-158. Art 35 provides that technology transfer contracts may stipulate the scope of exploitation of patents or the use of non-patented technology by the transferor or the transferee, provided that contractual clauses shall not be employed to restrict technological competition and technological development.

5. Performance of the obligations under the contract should be based on the principle of honesty and good faith.
6. An arbitral organ or a people's court should adjudicate contractual disputes on the basis of honesty and good faith.

The principle of public order and good custom under Article 7 is to some extent similar to the common law principle of public policy and its application will surely be dependent upon, among other things, the value judgement of the court and the policies of the central government and the Chinese Communist Party.

While a contract that contravenes the principle of public order or good custom is void under Article 33, the effect of breaching articles 3, 4, 5 and 6 is unclear. One is tempted to ask: what is the purpose of setting out the basic principles in Chapter 1 of the Code?

FORMATION OF CONTRACT

INTRODUCTION

Chapter 2 contains 23 articles covering the formation of contract. Articles 8-23 contain provisions on offer and acceptance. These are important provisions, as under the existing contract legislation, there are no provisions for offer and acceptance "because within a planned economy a contract is signed according to whatever plan is determined by the government, and not according to the free-will of contracting parties. By contrast, one of the proposed goals of the new contract law is to prevent excessive interference into the formation of contracts and thereby to facilitate the operation of the market economy".³⁷

OFFER

An offer is an expression of the desire to conclude a contract. To be valid in law, the content of an offer has to be definite and it should also indicate an intention of the offeror to be bound if the offer is accepted (Art 8). An offer becomes effective when it reaches the offeree (Art 9).

³⁷ (Spring 1995) 9(1) *Journal of Chinese Law* 67 at 70-71.

An offer may be withdrawn, but the notice to withdraw should reach the offeree before the offeree has dispatched an acceptance (Art 10). An offer may be revoked if the revocation reaches the offeree before he has dispatched an acceptance. However, an offer cannot be revoked: (1) if it states a fixed time for acceptance or if it indicates that it is irrevocable; or (2) if it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer (Art 11). Display of goods with a price, the provision of a vending machine and the sending out of a tender are regarded as offers, whereas the sending out of a price catalogue, an announcement of tender and an advertisement for goods are regarded as invitations to treat (Art 12). Where an advertisement offers a reward for performing a definite act, the person who performs the act should be rewarded, even though he is not aware of the advertisement for reward. The liability of the advertiser is discharged after he has paid the first person who has performed the act. The advertiser may advertise for the revocation of the advertisement, but he may be held liable to compensate a bona fide party who is engaging in performing the act, unless the advertiser can prove that it is not possible to perform the act advertised (Art 13). An offer may lapse if it is rejected or is not accepted within the prescribed period of acceptance (Art 14).

ACCEPTANCE

The offeree's indication of assent to the offeror's offer is acceptance. Acceptance takes effect when it reaches the offeror (Art 22). Silence or inactivity does not amount to acceptance (Art 15). Acceptance must reach the offeror within the time fixed by the offeror, or if no time is fixed, the following rules should be applied: (1) an oral offer must be accepted immediately. An offer made by telephone is regarded as an oral offer. (2) an offer other than an oral offer must be accepted within the time the acceptance should normally have reached the offeror, due account being taken of the usage, the nature of the transaction, and the rapidity of the means of communication employed by the offeror (Art 16). A period of time for acceptance fixed by the offeror in a telegram or a letter begins to run from the moment the telegram is handed in for dispatch or from the date shown on the letter or, if no such date is shown on the letter, from the date shown on the envelope.

A period of time for acceptance fixed by the offeror by telephone, telex or other means of rapid communication begins to run from the moment the offer reaches the offeree (Art 17). If the offer prescribes the mode of acceptance, this must be followed. Otherwise, the mode of acceptance must be reasonable (Art 19). Generally, late acceptance is regarded as a new offer. However, a late acceptance is effective as an acceptance if without delay the offeror so informs the offeree. If the notice of acceptance shows that it has been sent in such circumstances that if its transmission had been normal it would have reached the offeror in due time, the late acceptance is effective as an acceptance unless, without delay, the offeror informs the offeree of the late acceptance, otherwise the late acceptance is effective as an acceptance (Art 20). Acceptance must exactly fit the offer, otherwise it will be regarded as a rejection of the offer and will be treated as a new offer. A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror, without undue delay, objects or the offer clearly prohibits any additions, limitations or other modifications. The terms of the contract are the terms of the offer with the additions, limitations or modifications contained in the acceptance (Art 21). An acceptance may be withdrawn if the withdrawal reaches the offeror before or at the same time as the acceptance would have become effective (Art 23).

It seems that many of the provisions in the Code on offer and acceptance are based on the relevant provisions in the United Nations Convention on Contracts for the International Sale of Goods 1980.

FORM OF CONTRACT

On the form of a contract, Article 24 provides that subject to any law or administrative regulation, a contract may be formed orally, or in writing or in any other form as agreed to by the two parties. This should be contrasted with the relevant provisions in the contract legislation

which requires a contract to be in writing.³⁸ A contract which does not comply with the formality prescribed by law maybe confirmed valid by the court, if the party who has fully performed his obligations or who has performed his main obligations so requests (Art 32).

ESSENTIALS OF A VALID CONTRACT

Article 31 provides that the essential elements of a valid contract are as follows:

1. The parties should have the capacity to contract;
2. The real intent is expressed;
3. There is no violation of the law, public order and good custom;
4. The subject matter is certain and possible.³⁹

VOID CONTRACTS

A contract which violates the law, public order and good custom is void (Arts 33-34). A term in a contract which exempts liability arising from intentional or grave fault, personal injury, breach of consumer protection law (which liability cannot be exempted under the law) and breach of public order and good custom is void (Art 34). If the subject matter of the contract is impossible from the very beginning, or cannot be ascertained at the expiry of the time for performance, the contract is void (Arts 35-36). But if the impossibility can be removed and at the time of the contract the parties foresee that the contract can be carried out, the contract is valid (Art 36). There are also provisions relating to the validity of a contract entered into

³⁸ Art 3 of the ECL provides that economic contracts, except for those in which accounts are settled immediately, shall be in written form. Art 7 of the FECL provides that a contract is formed when the parties have reached agreement on the provisions of the contract and signed in a written form. If the agreement is reached through correspondence, telegrams, or telexes, and one party requests the signing of a confirming document, the contract shall be considered to be formed only at the time of the signing of the confirming document. Art 9 of the Technology Contract Law provides that the conclusion, modification and rescission of a technology contract shall be in written form.

³⁹ Cf Art 55 of the GPCL which provides that a civil legal act must satisfy the following conditions:

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

by an agent⁴⁰ or by a person who does not have capacity or full capacity to contract.⁴¹

Provisions in a standard form contract may be void if they are against the principle of honesty and good faith.⁴² Any ambiguity in the standard form contract must be resolved against the person who is seeking to rely on it (Art 58).⁴³

VOIDABLE CONTRACTS

Article 47 provides that a party who enters into a contract as a result of fraud of the other may request the court to set aside the contract, unless the fraud is committed by a third party and the other party acts in good faith. A contract may become voidable because of duress, grave mistake of the nature of the contract, the identity of the other party, or the subject matter, or because of other mistakes relating to an important item in a transaction.⁴⁴

If the rights and duties of the parties under the contract are obviously unequal so that one party is at a serious disadvantage, the disadvantaged party can request the court to set aside the contract (Art 50).

If a contractual party or both contractual parties enter into a contract as a result of duress or undue influence of a third party, they may ask the court to set aside the contract. But if one party acts in good faith, the other party cannot ask the court to set aside the contract, although he is entitled to damages from the third party who commits the duress or undue influence (Art 51).

A party who is entitled to rescission may ask the court to simply vary the contract. If a party requests variation of the contract, the court cannot rescind it; but if a party asks for rescission, the court has a discretion either to rescind or vary the contract. A contract that has been rescinded has no effect from the very beginning. The right to rescission may lapse after one year from the formation of the contract (Art 52).

⁴⁰ See Arts 37-41.

⁴¹ See Arts 42-46.

⁴² See Arts 55-57.

⁴³ This is similar to the *contra proferentem* rule.

⁴⁴ See Arts 48 and 49.

EFFECTS WHERE A CONTRACT IS VOID OR RESCINDED

If a contract is void or is rescinded, property acquired by one party must be returned to the other party; if it cannot be returned or if it is not necessary for it to be returned,⁴⁵ the property should be evaluated and the evaluated amount be paid to the other party as compensation (Art 53). A party who was at fault must compensate the other party for the loss caused thereby; where both parties were at fault, each must bear an appropriate amount of liability (Art 54).⁴⁶

PERFORMANCE OF CONTRACT

A contract should be strictly performed. Performance must be made in accordance with the nature of the contract, the practice of the transaction and the principle of honesty and good faith.⁴⁷ In performing the contract, one party is obliged to work in concert with the other party.⁴⁸ Article 71 provides that if the provisions in the contract relating to the quality and quantity, price, time of performance, place of performance and mode of performance are unclear, or if there are no such provisions in the contract, the following rules may apply:⁴⁹

1. If there are no provisions relating to the quality and quantity or if the provisions are unclear, the contract should be performed in accordance with the state standards. If there is no state standard, it should be performed in accordance with the trade standard; if there is no trade standard, it should be performed in accordance with usual standard of similar goods.

⁴⁵ What it actually means is unclear.

⁴⁶ Cf Art 61 of the GPCL. Art 61 also provides that where both parties have maliciously conspired and performed civil acts harmful to the interests of the state, a collective or a third party, property acquired by them must be recovered and becomes property of the state or the collective or is returned to the third party.

⁴⁷ See Arts 63 and 64.

⁴⁸ See Art 65.

⁴⁹ Cf Art 88 of the GPCL.

2. If there are no provisions relating to the price or if the provisions are unclear, the contract should be performed according to the state price. If there is no state price, it should be performed in accordance with the market price of the place of performance of the contract. If there is no market price, it should be performed in accordance with the price of similar goods. If the contract provides a method for fixing the price, the price should be fixed in accordance with that method.
3. If there are no provisions relating to the time of performance or if the provisions are unclear, the obligor may perform his obligation at any time, and the obligee may also at any time demand the obligor to perform his duty. One party should give to the other party time necessary for preparation for performance.
4. If there are no provisions relating to the place of performance or if the provisions are unclear, payment in cash is made at the place of the recipient; transfer of real property is made at the place where the real property is situated; and for other subject matters, at the place of the obligor.
5. If there are no provisions relating to the mode of performance or if the provisions are unclear, performance should be made according to the requirements of the nature of the contract that are beneficial to the realisation of the purpose of the contract. If the contract does not provide for different performances, there is a presumption of one performance for the whole contract.⁵⁰

The provisions in the proposed Code contain some Chinese characteristics and to a certain extent reflect a planned economy. On the other hand, they could also be regarded as “statutory implied terms”.

A party may temporarily suspend performance of his obligations if there is definite evidence of the other party’s (i) loss of ability to perform his obligations under the contract; or (ii) lack of sincerity in performing and possible loss of ability to perform; or (iii) creditworthiness seriously worsening. The party that suspends performance should immediately inform the other party and should perform his obligations when the other party

⁵⁰ The original Chinese version is clumsily drafted.

regains his ability to perform or offers an appropriate performance guarantee. If, during the time for performance of the contract, the other party fails to regain ability to perform or to offer an appropriate performance guarantee, the party that suspends performance may terminate the contract (Art 67).

The contract may provide for performance being made to or from a third party. The third party's right to sue the obligor arises only when he clearly indicates to the obligor that he will accept performance, in which case the obligor may raise against the third party any defence or set-off which he could have raised against the obligee. The contract may provide that performance be made by a third party, but if the third party fails to perform, he is not legally liable to the obligee; and the obligor is bound to effect performance himself.⁵¹

To preserve his rights, the Code allows the obligee to be subrogated to the position of the obligor so as to enable him to sue in his own name any third party who does not perform his (the third party's) obligations. This right can be exercised only when the obligor fails to diligently enforce his rights against the third party (Art 72).⁵² An obligee may apply to the people's court to stop any act on the part of the obligor if the act is detrimental to the obligee's rights under the contract, but the application must be made within one year from the time the obligee is aware of or should be aware of the reasons for the application (Arts 73-74).

ASSIGNMENT OF CONTRACTUAL RIGHTS AND DUTIES

Unless the contract or the law provides otherwise, an obligee may assign his contractual rights to a third party, except if the nature of the contractual rights do not allow assignment.⁵³ Once the contractual rights have been assigned to the assignee, the latter will also acquire related rights such as rights to securities and interest (Art 77). After assignment, the assignor undertakes to deliver to the assignee documentary proof of contractual rights

⁵¹ See Arts 68-70.

⁵² The right to be subrogated is subject to law. Further, the nature of the obligations may prohibit subrogation (Art 72).

⁵³ See Arts 75-76.

and the property in his possession,⁵⁴ to pay for any additional expenses that will be incurred by the obligor in performing his obligations as a result of the assignment, and to provide to the assignee all the necessary information and cooperation to enable the assignee to exercise his rights (Art 78). To ensure validity, assignment must be brought to the notice of the obligor, who may raise any defence against the assignee which he could have raised against the obligee/assignor.⁵⁵

With the consent of the obligee, a third party and an obligor may enter into a contract whereby the third party will undertake performance of the obligor's obligations, in which case the third party is entitled to raise any defence against the obligee which the obligor could have raised.⁵⁶ It is also possible for the obligee and a third party to enter into a contract whereby the third party will undertake performance of the obligor's obligations (Art 87).

DISCHARGE OF CONTRACT

A contract may provide for circumstances under which parties' obligations may come to an end (Art 95). The proposed Code also provides for "Legal Discharge". Notice of termination once given cannot be revoked (Art 102).

A contract may be discharged by law under the following circumstances:

1. It is not possible to perform the contract.

If it is not possible to perform the contract, either party is entitled to terminate the contract (Art 96).

2. If the obligor refuses to perform his obligations, whether performance is due or not, the obligee is entitled to terminate the contract (Art 97).
3. If one party delays in performing, the other party should prescribe a reasonable period of time and urge the party that delays in performing to perform within the prescribed time. If performance is not forthcoming, the affected party is entitled to terminate the contract (Art 98).

⁵⁴ Presumably, it refers to the property owned by the obligor and possessed by the obligee.

⁵⁵ Arts 80 and 82.

⁵⁶ See Arts 87-88.

4. If, according to the nature of or provisions in the contract, the contract is not performed within the prescribed time, its purpose may be frustrated if one party delays in performing, the other party is entitled to terminate the contract (Art 99).
5. If the contract has been performed but not in accordance with the contractual requirements, the performance may be rectified by the party in default, provided that after rectification, the purpose of the contract may still be achieved. The party who is not in default may prescribe a reasonable period of time and urge the party whose performance does not comply with the contract to perform within the prescribed time. If performance is not rectified within the prescribed time, the affected party is entitled to terminate the contract (Art 100).
6. If there is partial performance, the obligee is entitled to refuse to accept any purported performance of the other obligations. If performance of the other obligations will not benefit the obligee, the obligee may rescind the whole contract. If, according to the nature of the contract or the intention of the parties, non-performance of the accompanying obligations that does not frustrate the purpose of the contract will not entitle the obligee to terminate the contract (Art 101).

Once a contract is discharged, the two parties shall be restored to their pre-contractual positions. The rules relating to restoration as set out in Art 103 are as follows:

1. Property should be returned;
2. If the subject matter received is money, the interest should also be returned;
3. If the subject matter received is services or the right to use the goods, payment of an appropriate amount should be made;
4. If the subject matter produces an additional thing, both the subject matter and the addition should be returned;
5. Necessary expenses or expenses incurred for the benefit of the recipient arising from the return of the property should be paid for; and

6. The price of the property should be paid if the property is destroyed, lost or cannot be returned because of other reasons.

The fact that the contract is rescinded does not affect a party's right to sue for damages arising from non-performance of the contract. The damages will include the necessary expenses incurred for entering into the contract, the necessary expenses incurred for the preparation of the contract, damages for loss of opportunities to enter into contracts with a third party; loss arising from the obligee's refusal to perform his obligations, and expenses incurred arising from the return of the property (Art 104).

THE EXTINCTION OF CONTRACT

A contract will be extinct if the obligee is paid off; or the parties set off each other's debts; or the obligor deposits the subject matter with the government organ that accepts the deposit, or if there is a merger of the obligee's rights and his obligations to the obligor, or if the obligee releases the obligor's obligations from the contract.⁵⁷

LIABILITIES FOR BREACH OF CONTRACT

A party is liable for breach of contract if he does not perform his obligations or if he does not perform according to the contractor to law (Art 138), or if there is defective performance (Art 145).⁵⁸ He is liable even if the breach is caused by the fault of a third party with whom he is related legally (Art 139). If the impossibility of performance is due to *force majeure*, he may be exempted from liability partly or wholly. But he is obliged to promptly inform the other party of the force majeure event and provide the relevant organ with valid proof (Art 140).

If before the day for performance the obligor expressly indicates to the obligee that he is not going to perform his obligations, the obligee is entitled to sue immediately without waiting for the time when performance will become due (Art 141).

⁵⁷ See Arts 110-137.

⁵⁸ The obligor is liable for any injury to the body or property (other than the subject matter of the contract) of the obligee arising from defective performance (Art 145).

AGREED AMOUNT FOR BREACH OF CONTRACT

The contract may provide for the payment of an agreed amount for breach of contract by the obligor if he does not perform or properly perform his obligations (Art 146). Unless the contract provides otherwise, the amount payable will be regarded as damages for breach of contract fixed in advance, and thus if the obligee requests the obligor to pay the agreed amount, he cannot at the same time demand continued performance or damages for breach of contract (Art 147).⁵⁹ The agreed amount will be reduced to the extent of the obligations which have been performed (Art 148). If the agreed amount is substantially higher or lower than the loss caused by the breach of contract, the party affected may ask the court or arbitral body to make an appropriate reduction or increase (Art 149).

DAMAGES FOR BREACH OF CONTRACT

The contract may provide for a fixed amount of damages payable for breach of contract or may stipulate the method for calculating the damages payable for breach of contract. In the absence of any agreement, the damages payable should include the obligee's actual loss and possible loss of benefit,⁶⁰ which should not exceed the possible loss that the party in breach can foresee or should have foreseen, taking into consideration the facts and circumstances known to him at the time of contract (Art 151). If the loss or its enlargement is also due to the fault of the innocent party, the damages payable by the party in breach may be reduced or his liability be exempted (Art 152).

⁵⁹ This limitation does not apply if the breach of contract damages is for delayed performance (Art 147). It should be noted that according to the ECL, the innocent party having received the breach of contract damages from the obligor is entitled to demand continued performance (Art 31).

⁶⁰ Any benefit which the innocent party has acquired will be taken into consideration in assessing damages (Art 153).

OTHER MODES OF LIABILITY

Specific Performance

Even though the obligor is in breach of the contract, if performance of the contract is still possible, the obligee, instead of rescinding the contract, may apply to the court for an order of specific performance, unless the expenses that will be incurred for performance is astronomical or by virtue of the nature of the contract it is not appropriate for the court to order specific performance (Art 154).

Deposits

If the party that pays a deposit breaches the contract, he shall have no right to claim return of the deposit. If the party that receives the deposit fails to perform the contract, he shall return twice the amount of the deposit. In calculating the damages for breach of contract, the amount of deposit paid will be taken into consideration. But if the deposit exceeds the damages, the provisions relating to deposit will prevail (Art 155).

Defective performance

If there are defects in the subject matter, the obligee is entitled to repair, replacement, and damages (Art 156).

Liability of the third party

If a party's right is violated by a third party who intentionally acts against good custom, the third party will be liable to compensate the innocent party.⁶¹

⁶¹ It is a bit strange to find such a provision in the proposed contract Code, as the third party is not a party to the contract. He should be made liable under the law of tort.

CONTRACTUAL AND TORTIOUS LIABILITIES

If the obligor's act that causes damage to the obligee constitutes a breach of contract and a tort, the obligee has an option to sue either for breach of contract or under tort (Art 158).

INTERPRETATION OF CONTRACT

Until now Chinese legislation did not contain any provisions on interpretation of words or expressions in the legislation. The proposed Code has a chapter⁶² on interpretation of contract. The rules relating to interpretation of contract as set out in articles 159-164 are as follows:

1. The common true intention of the contractual parties must be sought in the interpretation of the contract and the interpretation should not be limited to the words used (Art 159).
2. Contractual clauses must be interpreted by reference to each other to determine their correct meaning in the contract as a whole (Art 160).
3. Words or clauses susceptible to two meanings ought to be interpreted in the sense that best suits the purpose of the contract (Art 161).
4. Where the meaning of a word or an expression used in the contract is ambiguous, reference should be made to the usage of the parties (Art 162).
5. Contracts should be interpreted according to the principle of fairness. A gratuitous contract should be interpreted in a way that will impose lighter obligations on the obligor. A non-gratuitous contract should be interpreted in a way that will be fair to both parties. Where there is ambiguity in the meaning of a clause, it should be interpreted against the party that decided on the clause (Art 163).
6. Contracts should be interpreted according to the principle of honesty and good faith (Art 164).

⁶² See Chapter 9, Arts 159-164 on interpretation of contract.

SPECIFIC CONTRACTS

The proposed Code contains provisions relating to specific contracts, such as sales, carriage, loans, insurance, agency, guarantees, technology transfer, bailment and employment.⁶³

CONCLUSION

The recent amendment to the ECL and the proposed contract Code reflect, to a considerable extent, the Chinese socialist market economy. It is also obvious that Chinese contract law will contain a number of civil law and common law principles. It will be interesting to note how Chinese lawyers and judges, trained in the socialist legal system, will interpret and apply the provisions in the proposed Code to the facts of the case before them.

⁶³ See Arts 165-525.