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Mission to China of the Section of International Law of the American Bar Association

*by Henry T. King, Jr.**

IN NOVEMBER 1978, I chaired the American Bar Association's Section of International Law delegation to the People's Republic of China (PRC). Included in the delegation were representatives of the various constituencies of the Section, including corporate counsel, professors, and representatives of law firms. The delegation included specialists in the various fields of international law including maritime law, patent law, contract law, and other phases of international business law. The representation was geographically diverse and included a number of Chinese-speaking persons.

After extensive briefings in New York with the assistance of leading Chinese specialists on the faculty of Columbia University and representatives of the National Council for United States-China Trade and the National Committee on United States-China Relations, Inc., the delegation flew to Belgrade, Yugoslavia where it met with United States Embassy representatives. Thereafter, the delegation held extensive meetings with key officials of the Institute of Comparative Law of Yugoslavia and also leading members of the Bar of Yugoslavia. The purpose of these meetings was to apprise the delegation of the various features of the Yugoslav economic systems which the Chinese have been very much interested in and which may well afford a pattern for Chinese economic development. The Yugoslavs have a system of worker self-management and also have developed with a considerable degree of success, a number of joint arrangements with foreign business entities such as co-production agreements, compensation agreements, and contractual joint ventures. A number of Chinese delegations have visited Yugoslavia and it is felt that the Chinese will use the Yugoslav model in reorienting their own economic system so as to secure foreign participation in terms of capital and technology.

After departure from Belgrade, the delegation proceeded to Urumchi which is the capital of the semi-autonomous Province of Sinkiang and

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which had been a pit-stop for Marco Polo in his travels to China. Shortly thereafter, the delegation proceeded to Peking where arrangements were made for meetings with the top legal officers of the China Council for the Promotion of International Trade (CCPIT) as well as the Law Institute of China and the Peking University Law faculty. The primary focus in these discussions was on trade and in that connection, our visit was most opportune since the Chinese were interested in building a legal support structure for the development of international business relationships between the PRC and the developed world. The CCPIT will, no doubt, play a key role in this activity since it advises Chinese trade corporations on legal aspects of contracts with foreign suppliers and customers. The Peking University Law faculty and the Law Institute of China are providing backup research for China's new legislation in the trade area.

In particular, the Chinese indicated to us that China was developing and planning to put into effect a patent law and a commercial law as well as a new maritime law, together with a criminal code and civil code. In terms of priorities, the new patent law and commercial law together with the criminal law seem to be on the front burner. Subsequent to our visit, Japanese circles reported that China was considering a new foreign investment law.

After its stay in Peking, the delegation proceeded to the cities of Nanking, Yangchow, Soochow, Shanghai and Kwangchow (Canton).

In Shanghai the group met with three judges of the Shanghai District Municipal Higher Court and interchanged ideas with them on the subjects of contract law, tort law and arbitration. Here, we also heard from them about the functioning of the Shanghai Court.

In Peking and Shanghai individual members or small groups from the delegation met with Chinese trade organizations such as the China National Technical Import Corporation, China National Machinery Import and Export Corporation, and the Bank of China. The group also observed the operation of large factories and small factories in both the heavy and light industry fields and visited an agricultural commune and a typical Chinese neighborhood in a large city. These latter visits were designed to give the group an idea of the functioning of the various organizations through which the Chinese economy and society operate.

I. THE ROLE OF THE LAWYER

Before outlining some of the legal issues which face United States businessmen and the Chinese in relating to one another, I think it is

appropriate to comment briefly on the role of the lawyer in the two societies.

In China, lawyers have historically played a very minor role in business and governmental affairs. A check of the backgrounds of the current top officials in China discloses that none of them is a lawyer. Lawyers in China have historically been looked upon with scorn and as "litigation tricksters." There has been, and currently is, a paucity of lawyers in China. The Peking University Law School which is currently in operation is a relatively small law school by United States standards and has a dearth of resources in terms of books, and other study materials. It is clear that there is a need for support from outside sources to help structure this law school to build its place in Chinese society and in China's economic and political life.

As far as we could determine, there are few, if any, practicing lawyers in China at this time. We were informed in Peking that there are two practicing lawyers in Kwangchow who will represent foreign clients, but during our visit to Kwangchow we were unable to confirm the location or existence of these lawyers. The CCPIT did inform us that should American clients require representation in China, they would identify lawyers who might be of help. With regard to the subject of representation, we did engage with the Chinese in some discussions concerning the question of practice by foreign lawyers in China and attempted to provide them with information as required.

The fact is that today there is no Bar Association in China and further there was no Chinese group of counterparts which our group could interface with throughout our visit. It was further noteworthy that we had to secure the meetings which we participated in on our own and that frequently we had to pressure quite hard to meet the groups we wanted to meet with. This does not mean, however, that those with whom we talked were not receptive to what we had to say and were not interested in engaging in an ongoing relationship in the future. Exactly the contrary is true.

The fact is that in the business area it has not been easy to secure the acceptance by the business entities of the PRC of the role of the lawyer in contract negotiations. Only with great reluctance have the Chinese trading corporations permitted foreign lawyers to participate in negotiations, and change in this regard has been glacial. Obviously, this situation will change with the passage of time.

The United States and the PRC seem to represent two extremes on the role of the lawyer. In the PRC the lawyer's role up to now has

been negligible while in the United States the reverse is true. The United States is a legally intensive society while the PRC is not, and in the United States business is conducted by corporations with limited resources, while in the PRC all its trading corporations are ultimately owned by a single body, *viz.*, the state. This latter fact has made for a conflict in approaches to contracts based on a divergence of business structures. In the United States a corporation wants to know what its liabilities are and what the contingencies are for which it has to provide, while in China where the state controls and owns everything, there is seemingly less need for such concern. Suffice it to say that the United States approach is to try to define in advance contractual rights and responsibilities and to plan for and anticipate contingencies and that this approach finds no parallel in Chinese thinking where the hope and anticipation is to work things out should unanticipated troubles arise.

There is evidence that the gap between the two societies in the legal area may be abridged somewhat in the future since, as pointed out above, the Chinese are now working on new patent and commercial laws as well as maritime laws. A Japanese report indicated further that the Chinese were working on new foreign investment legislation to cover joint ventures and various other forms of cooperation between Chinese and foreign entities. With the advent of all these new developments, the role of the lawyer will no doubt be strengthened in China for the future and the gulf which currently exists between the Chinese and the United States approach toward lawyers will inevitably narrow.

With the foregoing in mind, I think it appropriate now to identify some of the legal issues which give concern to United States lawyers in approaching the problem of doing business with China. These issues fall into two categories: Those issues which are concerned with the United States legislative and regulatory hurdles to doing business with China and those issues which are found in the gaps in China's legal backdrop for foreign business transactions or in the Chinese approach to contractual arrangements with foreign business.

II. UNITED STATES LEGISLATIVE AND REGULATORY HURDLES

A. *Import Restrictions*

1. Chinese Imports into the United States

The problem here is section 406 of Trade Act of 1974. It deals with market disruption by imports from a communist country. A peti-

tion was filed by the United States Work Gloves Manufacturers Association in 1977 against importation of work gloves from China and this was denied by the International Trade Commission (ITC). However, a second petition was filed by the Clothespin and Veneer Products Association alleging market disruption of the American clothespins market by China, Poland and Romania. This time the ITC found against the PRC.

2. Most favored nation (MFN) treatment

Under the Trade Act of 1974 presidential authority to negotiate an agreement extending MFN treatment to products of non-market countries such as the PRC is severely circumscribed. Under this law, the President must deny MFN treatment to any country which denies or impedes its citizen's efforts to secure the right or opportunity to emigrate. The President can issue a waiver of this prohibition if he determines that the waiver will substantially promote the objectives of the law (free emigration) and he has received assurances that the emigration practice of the country involved will substantially lead to the achievement of less restricted emigration. Waivers of this prohibition have thus far been issued with respect to Romania and Hungary. Unless a waiver is issued with regard to the PRC, China would be ineligible for MFN treatment.

B. *Financing Restrictions*

1. Export-Import Bank Financing

Communist countries which do not allow the free emigration of their citizens are ineligible for Export-Import Bank financing. Poland and Yugoslavia were exempted at the outset from his requirement. Hungary and Romania have been excluded from the prohibition by presidential waiver under MFN treatment which must be reviewed annually by the Congress. As of this writing the PRC would be subject to this prohibition.

2. The Johnson Debt Default Act

The Johnson Debt Default Act of 1934 prohibits private individuals and firms in the United States from "making any loan" to or purchasing or selling the "bonds, securities or other debt obligations of any foreign government" which has defaulted on obligations to the United

States Government. The Act encourages foreign governments to pay the debts owed to the United States Government by conditioning the availability of private United States credit on such payment. There are defaulted obligations of the Republic of China to the Export-Import Bank incurred prior to 1947 which the government of the PRC refuses to recognize as its own. There is a complication here because the government of Taiwan and the government of Peking claim to be the only legitimate government of China. However, interpretations by the United States Attorney General have limited considerably the broad language of the Act. In particular, the Act has been held not to apply to export sales on a deferred payment basis or to referrals of payment pending development of earnings. The Attorney General has also ruled that the Act does not apply to operations of foreign branches of American banks when the branches are incorporated in a foreign country.

3. Public Law 480

By special legislation passed in 1978, Congress has approved credits to the PRC through the Commodity Credit Corporation's (CCC) short-term and deferred payment short-term credit programs.

C. *Blocked Assets and Foreign Claims Issues*

United States citizens have claims against the PRC arising from nationalizations and other takings of property since 1949. At the same time, the PRC and its nationals have assets in the United States which have been blocked by the United States Government under provisions of the Foreign Assets Control Regulations. Those persons having claims against the PRC in the United States are precluded from attaching any blocked property in satisfaction of their claims. However, if the PRC were to have any new unblocked assets in the United States such as cash in banks or ships or products, these could be subject to attachment by persons having claims against the PRC. The existence of this possibility has acted as a deterrent to ownership of property by the PRC in the United States.

The solution is for the PRC to waive its claims to the frozen assets in the United States in exchange for the settlement of the United States claims by awards of the Foreign Claims Settlement Commission. The United States has seized seventy-six million dollars in Chinese assets in the United States and there are certified losses of United

States claimants against China of \$196 million. If the assets were used to satisfy the claims the settlement might amount to forty cents on the dollar.

This issue is to be resolved presumably by political means rather than by legal means, but until it is solved, it presents a legal barrier to the development of trade between the United States and China.

D. *Export Controls*

Until February 1972, the PRC was classified under the export regulations as country group Z (along with Cuba, North Korea and Vietnam) and exports to it were strictly controlled. On February 14, 1972, the PRC was transferred to country group Y which includes the Soviet Union and most Eastern European countries. Exports to these countries are subject to much less stringent restrictions.

Even though much of products and technology data are subject to much less control than formerly was the case, United States export controls still present a considerable barrier to trade between the United States and the PRC. From the discussions I had with PRC representatives, it was evident this was not only a very sensitive issue but also one which makes a continuing flow of trade difficult in certain product areas. PRC representatives cited the case of a satellite which was supplied by RCA pursuant to the Nixon visit in 1972 and for which, because of United States export controls, they could not get a vital part. One of the problems here is whether other Western nations, especially those which are a part of the multilateral Consultative Group (CG) and its permanent working committee, the Coordinating Committee (COCOM), are also as restrictive in their transfers of goods and technology to the PRC.

III. CHINESE ASPECTS

A. *Joint Ventures*

The Chinese industrial economy is almost entirely socialist, owned by the state or collectively by the communes. In the socialist stage which China is currently in, there is virtually no private ownership of means of production. This means that there are theoretical barriers to joint ventures in which foreign investors have an equity interest in Chinese property. Yet, there have been consistent reports out of Peking to the effect that the Chinese government was planning to enact a law to make joint ventures with foreign firms possible. As indicated

previously, the Chinese have shown a great interest in the Yugoslav model for joint arrangements with foreign firms. These are contractual rather than equity joint ventures. What may develop in China are arrangements which parallel the Yugoslav model whereby capital equipment, industrial property, technical assistance and know-how are supplied by the foreign partner to the government or local partner in return for royalties which may depend on production, sales, profits, and the like.

B. *Patents*

China currently has no system for registration of foreign patents and has no laws which regulate licensing of technology to China. This means that an American firm transferring technical property to China pursuant to a license arrangement has no statutory protection for subject property. In this respect, China is unlike any other major country in the world. Thus far, China has been willing to give foreign transferors of technology to China contractual protections pursuant to which the Chinese entity which is party to the contract has agreed to keep the technology secret, not to duplicate it and not to transfer it to any other entity. At the same time, the Chinese have shown some flexibility in agreeing to restrictions on the export of products produced with such technology.

The foregoing arrangements have satisfied some foreign licensors but the lack of a patent system has raised doubts with other potential transferors of foreign technology to China. These potential licensors want statutory protection in the form of a patent system for their technology. Consequently, China has indicated that it is now considering the adoption of a patent system which would protect not only domestic inventions but foreign technology which would be registered under the Chinese patent system. Since China will rely heavily on Western technology for its development at least until the year 2000 when the Four Modernizations program will be completed, the institution of a patent system would be a significant step forward in the promotion of China's future development.

C. *Trademarks*

A law providing for the registration of trademarks was passed in 1963. Trademarks of United States firms may now be registered in China. Registration of a foreign trademark in China is granted to the

first applicant on an exclusive basis for ten years. Registered foreign owned trademarks may be assigned to other foreigners. A number of United States firms have already registered their trademarks.

D. *Taxes*

Taxes seem to propose no problem currently in China. China imposes no income taxes at all on foreign firms much less taxes on a foreign licensor for payments made by a Chinese licensee.

American firms selling to the Chinese usually want a clause which protects them from Chinese taxes. There has been some reluctance on the part of the Chinese to agree to such a clause. On the other hand, this would seem immaterial at this time if China does not impose taxes on foreign entities. However, on the basis of the experience United States businessmen have had in the Soviet Union, the situation may be expected to change in the future and perhaps a clause covering the tax question would be desirable.

E. *Choice of Law Clause*

In most contracts entered into by United States firms overseas, the United States party usually likes to have a choice of law clause which would provide a reference to the law which would govern the contract. Many contracts with the Chinese are actually signed in China. Absent a choice of law clause designating another law to govern the contract, Chinese law would normally govern the contract under conflict of law rules. However, in China the problem is that there is no definable Chinese commercial law, either in statutory form or as reflected in foreign trade cases. This has posed a problem for United States lawyers in dealing with the Chinese and one which is made more difficult by virtue of the fact that the Chinese have been unwilling to provide that another country's law would govern the contract. There have been exceptions to this position on the part of the Chinese but these are few indeed. The Chinese have indicated that they are going to adopt a commercial law which may well be patterned after one of the continental systems in Europe. Once this is done, this hurdle to dealings with the Chinese would to a considerable extent be removed. Absent such a commercial law, it is particularly important that the contract be as full and complete as possible so that the rights and duties of the parties are specified. Here, another problem has arisen because of the Chinese adherence to form contracts which are frequently quite abbreviated. In such cases where disputes have arisen, the Chinese say

that they resort to customary usage in the trade, contract provisions and Chinese laws as sources in interpreting the contract. However, these three sources have not always been as full and complete a frame of reference as desired by American lawyers, thereby making negotiations with the Chinese difficult in this area.

F. *Dispute Settlement*

The basic approach of the Chinese on dispute settlement historically has been that of negotiation followed by joint conciliation and arbitration before the Foreign Trade Arbitration Commission in Peking. With regard to the situs of arbitration, the Chinese have alternatively been willing to agree on the situs of the defendant. There has been concern on the part of United States parties dealing with China about the possibility of going to arbitration in Peking before the Foreign Trade Arbitration Commission of China which is an all Chinese body. Language and distance present problems for those who would be compelled to arbitrate in Peking. Generally, on East-West trade matters the United States approach has been to provide for arbitration in a neutral country such as Switzerland or Sweden with a chairman from that country.

G. *Force Majeure Clause*

As buyers, the Chinese insist on penalties for late delivery in their contracts. However, an exception to the penalty requirement are those situations where *force majeure* exists. The Chinese have been willing to accept *force majeure* provisions in contracts but have been unwilling to specify just what constitutes *force majeure*. For example, would a United States export control regulation preventing shipment of products to China pursuant to a sales agreement constitute *force majeure*? Informally, the legal people at CCPIT informed us that they thought that this would be a case of *force majeure*. Another question arises concerning acts of God, strikes or lockouts. The Chinese do not recognize "acts of God" and there are no economically motivated strikes or lockouts in China. Here, an American firm may be faced with uncertainty which may at least exist in theory.

Another aspect of the *force majeure* clause which presents problems arises in connection with the options extended to the two parties to the contract if the *force majeure* situation lasts for more than ten weeks. Under the purchase contracts, the Chinese give an option to the

buyer to cancel but not to the seller. This presents a seeming inequity which the Chinese have thus far been unwilling to correct.

H. *Consequential Damages*

United States firms supplying equipment to China wish to limit their responsibility to the supply of goods as required by the contract. They do not wish to incur damages for loss of production due to the supply of faulty equipment. Specifically, they do not wish to incur consequential damages for equipment supplied to the Chinese. Here again, it has taken hard bargaining on the part of the United States firms and their lawyers to eliminate responsibility on the part of the seller for consequential damages. The Chinese have agreed in some cases to exempt the American supplier from responsibility for such damages but the going in this area has indeed been hard.

IV. SUMMARY

A plethora of United States statutory restrictions hamper trade with China. These affect both Chinese imports into the United States and United States exports to China. These restrictions also affect financing of United States-China trade by American banks and private firms. They present hurdles to United States-China trade arrangements which find no counterpart in Sino-Japanese trade and Sino-German trade. They need to be considered by any United States firm which wishes to deal with China.

In the legal area, United States-China trade presents special legal problems arising from the lack of a Chinese commercial law as well as the lack of a Chinese patent law. However, there are indications that these deficiencies will be remedied within the near future. There are conceptual barriers to the formation of joint ventures with foreign firms involving foreign equity participation in the ownership of Chinese property. Joint arrangements between Chinese entities and foreign firms will be made but they seem likely to follow the Yugoslav model of contractual joint ventures.

Another basic problem arises in United States-China contractual relationships from the approach which the Chinese follow on dispute settlement. The Chinese seem to be unwilling to follow almost every other nation in the world in resorting to arbitration of disputes by third parties. Contractually, there may be more Chinese acceptance of this approach but as of this writing, China has not in any case resorted

to arbitration in a third country. Another element which poses problems for the United States party dealing with the Chinese is the Chinese unwillingness to be as explicit about contract contingencies as would seem to be desirable. American firms entering into foreign contracts wish to define responsibilities and contingencies and to plan for them. In that way then costs can be pinpointed. On the other hand, the Chinese have thus far evidenced an unwillingness to provide for all contract contingencies and have endeavored to secure the acquiescence of American firms to the abbreviated contractual arrangements, with the exhortation on the part of the Chinese to "trust me" in the event that a dispute arises.

There is currently a wide gulf between the United States approach to the legal aspects of trade and the Chinese approach. This gulf will certainly narrow as we deal with and get to know one another but time is required for this process to take place. This coming together will occur as United States firms and Chinese entities negotiate and sign contracts covering individual transactions and develop experience under these contracts. But an additional dimension to this process could be a continuing exchange between representatives of the Section of International Law and Chinese specialists. This might not only be mutually educational but it could pinpoint considerations of some problem areas in the field of contracts where mutually acceptable solutions need to be developed.

It is submitted that China is a very special area for the American lawyer. It is unlike any other area the American lawyer will deal in. China has an identity and culture which are entirely its own and of which it is very proud. China has historically not taken kindly to lawyers, and China has taken a very limited view of their role and place in society. It therefore behooves the American lawyer who is going to China to acquaint himself thoroughly with China including its approach to law and legal institutions before departure. By doing so, he will no doubt be more effective when he arrives in China and begins dealing with the Chinese on contractual matters.

Lawyers and legally trained personnel will of necessity play a greater role in Chinese society in the future. Pressures in this direction will be generated by the explosion of China's trading relationship with the United States and other countries where lawyers play a significant role. It is hoped that the flowering of these relationships will promote a better understanding on the part of the Chinese of the usefulness of lawyers in finalizing business transactions and in anticipating contract

pitfalls. But pressures for expanding the role of legally trained personnel also will be generated by China's desire to get its own house in order by defining in contract terms relationships between its own industrial and agricultural entities. Finally, as China adopts new legislation in the commercial, patent and maritime areas, lawyers or legally trained personnel will be needed to interpret and administer such legislation.

