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Contracts, Practice and Law in Trade with China: Some Observations

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CONTRACTS, PRACTICE AND LAW IN TRADE WITH CHINA: SOME OBSERVATIONS

BY STANLEY LUBMAN*

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"Erh li gou doesn't mean 'early go' "

American businessman during trade negotiations in Peking, 1978.

Erh li gou ("two mile gully") is the street in Peking on which stands the "large import building", the headquarters of the Chinese state trade corporations which purchase machinery, equipment, chemicals and technology from abroad. The punning reference to the protracted length of negotiations there is relevant to this piece, because the writer spent seven weeks between mid-January and mid-April, 1978 participating in negotiations in Peking; the long stay provided an opportunity to test generalizations and to write with some immediacy.

This essay describes the process of negotiating sales of capital goods to the Chinese corporations and the contracts which embody such transactions, as seen by this writer in mid-1978.¹

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¹ See also Law and Politics in China's Foreign Trade (Victor H. Li ed. 1977), which is particularly helpful in describing the experience of China's European and Japanese trading partners and in settling forth contract forms; Gene Hsiao, *The Foreign Trade of China: Policy, Law, and Practice* (1977), a general overview; Dicks, *The People's Republic of China in East-West Business Transactions* 397 (R. Starr ed. 1974); Righizzi, *Legal Aspects of Trade with China*, 9 Harv. Int'l L. J. 85 (1968); Smith, *Standard Form Contracts in the International Commercial Transactions of the People's Republic of China*: 21 Int'l and Comp. L. Quart. 133 (1972); J. Dingle, *Technical Selling in China* (1974); and Holtzmann, *Resolving Disputes in U.S.-China Trade in Legal Aspects of U.S.-China Trade* (H. Holtzmann, ed. 1975). The *Far Eastern Economic Review* and The Asian Edition of the *Wall Street Journal* are indispensable for following current developments.

Change in foreign trade policy was very much in the air in Peking while this was being written, and negotiations and contracts alike reflect new policies. This essay also notes some recent developments in a related area that may affect China's foreign trade practice. Some indications appeared in early 1978 that China's domestic legal institutions were being strengthened and developed.

China's formal legal system has in recent years been conspicuously unimportant in influencing the making and application of rules, within China as well as in China's foreign trade. At its very least, the new policy toward law is an interesting expression of an aspect of the Chinese leadership's development strategy, and noteworthy for that alone; beyond that, it may have other implications.

Lack of space prevents detailed discussion here, but some likely subjects of future speculation can be suggested. China now seems to be traveling developmental roads which other societies have discovered, although they began at different starting points. It is worth noting, for instance, that as the idea of "self-reliance" becomes modified not only are China's imports of goods and technology increasing, but China's Minister of Foreign Trade has recently expressed willingness to consider transactions which the Chinese have previously resisted, such as manufacturing exports to buyers' specifications, incorporating components supplied by foreign buyers, and reviving barter. The next stage, already the subject of speculation in the West, may see assembly operations and more complicated transactions such as coproduction and product buyback arrangements. Hong Kong at the moment promises to be the focus of interesting experiments in Sino-Western trade and industrial cooperation.

At the very least, it is probably no coincidence that new interest in a variety of types of international transactions has been articulated contemporaneously with new emphasis on the domestic legal system. Without any specific connection between the two trends it is possible to note that they share an underlying receptiveness to the use of orderly and structured institutions for economic development operating according to increasingly regularized rules. Other policies announced in early 1978 reinforce this impression, particularly the intense emphasis on improving China's scientific and technological base and on improving the quality of education. Common to these policies and to the new emphasis on law is a willingness to entrust more responsibility to decision-makers because of their "expertness" rather than their "redness".

Beyond this confluence of trends lie further possible implications for increased regularization of Chinese society. Perhaps the time has come for the accretion of bureaucratic practice to be expressed in regulations and codes less tentative than much Chinese legislation in the past. Although it remains highly unlikely that the Western legal tradition, which had never taken hold in China before 1949, will exert a discernibly strong influence, pragmatism and the need to develop solutions to the problems of managing an increasingly more complex economy may impel Chinese planners to choose selectively from analogies derived from the experience of other nations, developed as well as developing.

It is too early to be confident that a lasting commitment has been made to fashioning and using institutions for implementing policies that reduce the use of mass mobilization and increase the making

and application of rules by officials charged with those tasks. Even if policy could change again, though, the present mood and current experimentation reflect an openness and flexibility that are striking by contrast to the policies that dominated the previous decade.

The pages that follow describe a mix of institutions and practices at a point in time that may be misleadingly fixed: Just as a river may be composed of currents moving at different speeds, the Chinese institutions discussed below, artificially captured in print, are changing unevenly, some hardly at all. The foreigner's point of view, like a watcher from the river bank, is limited. But because the institutions of foreign trade are those with which the foreigner can have the most sustained contact, insight into the operation of those institutions may furnish hints of less immediately visible developments.

I. NEGOTIATIONS IN PEKING

A. The Road to Peking

Since the purge of the "Gang of Four" in October, 1976, Chinese leadership policy has much stressed the importance and necessity of foreign trade, including the importation of equipment, machinery, whole plants, and technology. The new prominence of trade has caused the state trading corporations to multiply, to grow in size, and to increase the speed of their activities, but at the moment the foreign businessman must still be patient both in his efforts to get to Peking and to negotiate while he is there.

The decisions to purchase from abroad are made not by the trade corporations but by their "end-users" and the ministries to which they are responsible. Even if these units wish to purchase from abroad, they must compete with each other for the allocation of scarce foreign exchange with which to make the purchase. The planning of purchases and their financing is time-consuming, and for these reasons the foreign seller must expect that a Chinese response to his approaches may be long in coming.

Also, the sheer weight of business on the trade corporations makes for long delay. The volume of correspondence which they must carry on, within China as well as with foreigners, is extensive. Negotiations occupy their time, as do frequent consultations with end-users. The size, many layers and caution of the trade bureaucracy make for slowness in decision-making.

There is no single best route which a foreign seller may use to get to Peking. Alternatives which should be pursued are letters with appropriate enclosures of technical literature directed to the relevant trade corporations and to the China Council for the Promotion of Foreign Trade in Peking, direct approaches to members of the commercial section of the PRC's Liaison Office in Washington, attendance at the Canton Fair, approaches to Chinese delegations visiting the United States, representation on scientific or industrial delegations to China, and engaging an experienced advisor or agent to assist, support and coordinate the seller's approaches to China. These means of approach should not be regarded as mutually exclusive. Without discussing them here, it should be noted that in many cases attendance at the Canton Fair by exporters does not produce substantive technical or commercial discussions, because the trade corporations normally do

not send top-ranking officials to Canton to discuss purchases of items such as whole plants or complex equipment. The Fair, however, may be a useful forum for presentations, which are summarized and reported on when the Chinese officials at the Fair return to Peking.

Another route to the negotiating table is the technical seminar. The trade corporations have been increasingly interested recently in "technical exchanges" involving lectures and sometimes, demonstrations of equipment by technical specialists sent to Peking and occasionally to other Chinese cities by their companies. Such sessions offer an opportunity for sellers' representatives to talk directly to technically competent personnel representing the end-users themselves, which is not usually possible at the Canton Fair. Such technical seminars are expensive, involve considerable opportunity costs, and may not lead to commercial talks during the particular visit, but they are undoubtedly the most effective route which sellers can take in interesting end-users.

Another method of shortening the time which must elapse before a Chinese response is received is to translate considerable amounts of technical literature—not glossy advertising or a corporation's annual report—into modern Chinese and send it to the end-users directly, so that the recipients will not have to translate it themselves or pore over it in an unfamiliar language. Translation and printing services are provided by a number of organizations and companies in the United States and in Hong Kong.

If a foreign seller receives a response from Peking, it is usually a positive one, since if they're not interested, the trade corporations probably won't respond at all. When they do answer, they may ask for further information or for offers, or they may indicate an interest in holding negotiations in Peking. Upon receiving such invitations, the seller must then decide who to send.

B. Negotiations in Peking

It is usually a great mistake to send a representative of top management unless he has unusual competence to discuss his company's products. With due respect to the dignity and experience of high-ranking executives, the company representatives who make the best impressions on the Chinese are those who are most knowledgeable about the design and performance of their company's products. Obviously the seller must send a representative with authority to discuss price and other commercial details, and to negotiate and sign a contract. But it is in the technical sphere that it is vitally important to send particularly competent persons. As will be described below, competence becomes unusually important in the absence of good communications with the sellers' home office, which is a distinct and continuous problem in Peking.

The choice of personnel must be made, also, bearing in mind that the sellers' representatives may have to remain in Peking for weeks. The opportunity cost of sending very talented specialists to China may therefore be considerable. Men (or women) who are not cheerful about foreign travel, extended absences from home, long stays in hotels considerably more austere than those at home and the absence of night life may find themselves distinctly unhappy in Peking.

The negotiating team can fly to Peking from western Europe, Tokyo, or from Canton after having entered China via Hong Kong, although plane tickets are becoming harder to obtain because of the unprecedented Chinese push to increase tourism. If the travellers fly from Tokyo they may find that most of the seats on their plane are filled by Japanese businessmen, reflecting the considerable advantage Japanese exporters have over Americans in the China market by reasons of geographic proximity, pure competitiveness, and generally keener interest in exporting than most American companies.

Upon arrival in Peking, the sellers' team will be greeted by representatives of the trade corporation which has invited them. Americans are usually put up in the new wing of the Peking Hotel, which was erected four years ago and has spacious rooms. Most Japanese and some Europeans prefer the Hsin Chiao, which is smaller and older. Other hotels are also being used as the number of would-be sellers increases. The host corporations make these arrangements on behalf of visitors.

Once installed the sellers' team then falls into a more or less regular pattern. They breakfast early, and then, laden with briefcases and boxes of technical material, samples and plans, order a taxi to Erh li gou. The drive from the Peking Hotel is about twenty minutes, along roads shared with thousands of bicyclists, many large public buses, and a relatively small number of cars and trucks. If the visitors are staying at the Peking Hotel, they will be borne through Tien An Men, Peking's great square, past the entrances to the old Forbidden City and to Chiang-Nan-Hai, where China's top leaders live. It is impossible not to be stirred by the magnificent yellow-tiled roofs and red walls of the Forbidden City.

The ultimate destination, the "big important building," is considerably more mundane. As visitors arrive, many other taxis will be arriving at the same time, disgorging other businessmen—the majority of them Japanese—who have also come to negotiate. Until the spring of 1978, foreigners never even got above the ground floor, whose long, drab corridors are lined with doors opening into formal negotiating rooms of various sizes, always with long baize-covered tables separating one side of the room from the other. A brighter, newer, and larger multi-story building has been completed next door to the old one to serve as the center for negotiations. Each session begins the same way, with polite small talk about the weather and the offering of tea and cigarettes. The meetings usually begin at 8:30 a.m. at the earliest and end at 11:30, to resume at 2:30 and end at 5:30 p.m. One of the frustrations of this schedule is that, as willing as the seller might be to work longer hours in order to wind up the negotiations sooner, meetings outside normal hours are very rare.

C. Patterns

The Chinese participants will of course include representatives of the host organization, such as the China National Machinery Import and Export Corporation (often referred to for short by its cable address, "Machimex"). In addition, representatives of the end-users may also be present. In some negotiations the end-users assume the predominant role until the very end, when price and commercial details are settled. Often, the end-user's team will include comparatively young and inexperienced personnel who are obviously

present to learn. Machimpex or, sometimes the end-user, will provide an interpreter, and occasionally a relatively inexperienced interpreter may sit in for practice. Although the competence of the Chinese team, like their American counterparts, may vary considerably, the senior end-user personnel encountered recently have been particularly impressive and experienced, and the corporation negotiators are not without reason noted for being shrewd, careful, and observant of detail.

If the routine of negotiations is well-fixed, as has been suggested above, so, too, is their general over-all pattern. The Chinese will insist that all "technical" details should be discussed first, so that they will know exactly what the seller proposes to sell, before price and other contract terms are settled. Foreign sellers are usually surprised and often exhausted by the depth of detail which the Chinese side includes in the technical sphere. Sometimes, the questions may probe into details of design and research well within areas of information which the seller may regard as proprietary. On the other hand, when they discuss performance characteristics, the Chinese may be slow in coming forward with the climatic and other conditions under which they intend to use the seller's products, although their reticence may limit the seller's ability to discuss performance fully and slow the discussions. Sometimes the younger members of the Chinese team ask questions indicating much more unfamiliarity with the technology embodied in the sellers' product than that shown by their elders, who usually sit patiently while the sellers' representatives explain what they themselves may already know. It should be remarked, however, that the capacity of the Chinese side to absorb information quickly and learn from the negotiators is extremely high.

The relentlessness of the technical discussions can tire the sellers' representatives. Sometimes the questioners are youthful and eager, sometimes they are more experienced and very patient. Occasionally a whiff of faint mistrust may be felt from the Chinese side of the table, and indeed Chinese negotiators have sometimes remarked that on past occasions, especially in the early years of the People's Republic, they felt that they had been cheated by foreign sellers. The seller may be sure that whatever lines of inquiry appear at his sessions will be replicated at other meetings with his competitors, because once interest in particular products has been identified by the Chinese corporations, they seek out information from many sellers.

In the course of indicating the tasks they expect the sellers' product to perform, a number of recurrent emphases will usually emerge. The Chinese are sure to want the latest technology and the most advanced products, even if the seller may think them inappropriate for a developing country because of the level of training or experience which operators must have, problems of maintenance, or lack of other technology or equipment needed to attain the high levels of performance.

In their zeal for the latest and most modern equipment, the Chinese may want to automate operations usually performed manually; they often emphasize back-up systems and performance reliability to a particularly high extent. Consistent with their desire to obtain the most for their money, they may show great concern for the performance of the product over a very long period of time, a concern

which may cause problems when warranties are discussed. They may want what the seller considers to be an over-engineered system, showing concern with maintenance, testing and inspection. Safety considerations are also important. A recurrent and understandable concern is availability of spare parts, which often leads the Chinese to decide to purchase considerably more than sellers usually suggest or expect their purchasers to acquire. Also, in turnkey contracts, the Chinese will show concern for interchangeability of spare parts and equipment, and may specify sources and model numbers of equipment that they have already purchased in the past.

Another characteristic of negotiating with the Chinese corporations is the tenacity of their efforts to lower the seller's price. During technical discussions the Chinese side may express its expectations that the price should cover a considerable range of equipment which the seller does not ordinarily supply. In negotiations over the price itself, the seller may be told that his offer is "not competitive" or "above world market levels", or that he must "take a step forward". Often, the Chinese side may not even make a counter-offer, but continue only to whittle the price down.

No discussion of negotiating in Peking would be complete without considering the existence led by foreign sellers' representatives in that austere Northern capital. The Chinese hosts are certainly hospitable, and are pleased to arrange excursions to historic places such as the Great Wall and the Ming Tombs and to places of current interest such as factories and communes. Socializing with the Chinese side is limited to these occasions and to formal banquets which the two sides exchange from time to time. Apart from these contacts, however, the sellers' representatives are left to their own resources.

The hotels in which foreigners are housed offer little public space for entertainment or even lobby-sitting, and as a result the business visitor must use his room to entertain in, as well as to sleep and work. The isolation of the business visitor is dramatized when he goes out to one of Peking's fine restaurants for dinner. It is usually impossible to dine out unless the diner has made prior reservations and indicate the amount which he wishes to spend on the meal. At the specified hour he proceeds by taxi to the restaurant, where he will find a bustling place, full of the animation of ordinary Peking citizens eating in great good humor. However, the foreigner and his companions must usually dine in splendid isolation from the crowds, in a high-ceilinged room painted ochre or hospital green. The staff is usually good-humored and helpful, but the language barrier will normally prevent effective communication. The visitor and his companions must make their own party and then leave, in the taxi fetched for him by the restaurant staff.

Communications with the outside world remain a problem for foreigners in Peking. Cable charges to the United States are very high (37 cents per word), and the cable offices in the hotels close in the early evening. The hotels lack telex facilities, and should the business visitor want to send a telex he must order a taxi to take him to the central telegraphic office and there punch and send his own telex. He cannot receive incoming telex messages unless at the time he transmits his message someone at the receiving end wishes to reply while the line is open. A number of Japanese companies have their own telex facilities in Peking hotel rooms, and it is hoped that additional facilities will be made available for businessmen from other nations.

The foregoing has, it is hoped, given the reader an overview of negotiating with Chinese purchasers and the flavor of the life led in Peking by the foreign seller. The final outcome of successful negotiations is a contract which, like other aspects of Sino-foreign contacts, is likely to have certain patterns and characteristics of which the seller should be aware, and which are described in the following section.

II. CHINESE CONTRACT CLAUSES AND PRACTICE UNDER THEM ²

The prospective seller is well advised to examine standard clauses in Chinese purchase contracts and more importantly, to educate himself about Chinese practice.³ The pages which follow contain a summary which may be useful, both to sellers and others interested in Chinese attitudes toward international commerce.

A. Shipment

Chinese purchases from abroad usually are on F.O.B. or F.A.S. terms.⁴ Although certain standard contract forms do not use the term "F.O.B." the clauses on these forms spell out the responsibilities of the parties in a manner consistent with the common understanding of the term. For instance, these contracts clearly specify the documents, including a "clean on board ocean bill of lading marked freight to collect," which the seller must present to the Bank of China when he wishes to negotiate a draft drawn on the letter of credit opened by the Bank. Another common clause states that the risk passes when the goods have "passed over the vessel's rail and been released from the tackle."⁵

Standard forms used by the Chemicals, Minerals and Metals, and Machinery Corporations contain clauses clearly identified as F.O.B. terms. These require the Chinese shipping agent, the China National Ship Chartering Corporation, to notify the seller of arrival of the vessel a fixed number of days before the arrival date.⁶ The Machinery and Minerals and Metals Corporations require the seller to notify them 30 days before the agreed time of shipment, together with details of the shipment that will allow the Chartering Corporation to book shipping space accurately.

F.O.B. clauses may vary as to the calculation of liability for storage expenses in the event a seller has delivered cargo to the port of shipment as agreed but the Chinese vessel arrives late. The standard Chemicals Corporation form states that such losses are to be calculated "from the 16th day after expiry of the free storage time at the port,"⁷

² Portions of this section were previously published in Lubman, *Trade Between the United States and the People's Republic of China, Practice, Policy, and Law* 8 Law and Policy in Int'l. Business 1 (1976).

³ A standard Machimpex Purchase Contract is reproduced as an Appendix and hereafter cited as "Machinery Contract". For a collection of standard Chinese contract forms see National Council for U.S.-China Trade, Special Report No. 13, Standard Form Contracts of the People's Republic of China (1975).

⁴ Under an f.o.b. (free on board) contract the seller is required to make available at the port of loading the goods specified in the contract, and to pay all handling and transport charges for the goods specified in the contract, and to pay all handling transport charges for the goods up to the time of their passing over the ship's rail. See Schmittkoff, *Export Trade*, 14-15 (5th ed. 1969). Under f.a.s. (free alongside ship) terms the seller is not responsible for loading, and his responsibility ends when the goods are landed alongside the vessel so that they can be loaded. *Id.* at 12-13.

⁵ Reghizzi, *Legal Aspects of Trade With China: The Italian Experience*, 9 Harv. Int'l J. 85 (1968) at 101 n.54. Reghizzi comments that "[s]ome Italian businessmen have expressed their perplexity and difficulty in reconciling this clause with the subsequent right of the Chinese to inspect the goods and present claims after so many days have passed from the shipping of the commodities." *Ibid.*

⁶ The machinery contract included in the Appendix specifies 10 days notice. Machinery Contract, cl. 12(1)(c). Contracts used by other corporations vary slightly.

⁷ Chemicals Purchase Contract, "Terms of Delivery," cl. 1, in Standard Form Contracts, *supra* note 3, at 25.

while the standard Machinery Corporation clause simply states that if the Chinese vessel "fails to arrive at the port of loading within 30 days after the arrival date advised by the Buyer, the Buyer shall bear the storage and insurance expenses incurred from the 31st day.⁸ Some flexibility may be shown in negotiations on this clause.

Demurrage is an item to which the seller should be particularly attentive. When the Chinese purchase on F.O.B. terms they provide clearly that the seller is liable for demurrage if the goods are not ready when the vessel arrives at the port on time. However, the CIF terms are silent on demurrage, and sellers under these terms who have not insisted on demurrage clauses have suffered considerable losses when unloading of their vessels was delayed at congested Chinese ports.

B. Payment

1. STANDARD TERMS

The standard Chinese payment clauses provide that upon receipt of the shipping advice which the seller is required to send the Chinese buyer, the buyer will open an irrevocable letter of credit with the Bank of China, which is payable against presentation of a draft drawn on the Bank and the shipping documents described elsewhere in the contract. The letter of credit normally is valid until 15 days after shipment, and the documents are negotiated at a Bank of China branch in the P.R.C. The Chinese usually insist upon confirmed letters of credit in payment for their exports. When they are the buyers, however, they are well known for their reluctance to allow letters of credit to be confirmed. If during contract negotiations the seller asks for a confirmed letter of credit, the Chinese negotiator likely will say that there is no need to obtain confirmation. Insistence on it may be taken as an insult to the credit of the People's Republic of China.

The combined effect of the practices described above is that the seller who has shipped the goods and presented the documents loses control over both for a brief period of time.⁹ Chinese letters of credit reportedly have contained clauses allowing inspection of the goods after they have arrived. These clauses theoretically would transform the letters of credit from irrevocable obligations into conditional promises to pay. This potentially troublesome practice has caused little difficulty, although delays in payment and deductions for alleged imperfections found on inspection have been known to occur.¹⁰ Chinese practice apparently is not uniform, since other letters of credit clearly indicate that the transaction is a documentary one as is customary in international trade, and that the Bank of China will pay by airmail transfer provided that the "detailed name of the commodity, specifications, quantity, price, manufacturer and packing shown in the documents are found, upon presentation, to be in conformity with [with contract]." ¹¹

⁸ Machinery Contract, cl. 12(1)(c). Normally, title to the goods remains with the seller, who cannot be paid until the bill of lading has been transferred. It may be possible, however, to obtain Chinese agreement not only to pay for warehousing and insurance expenses after the 31st day, but also to pay for the goods themselves "against a warehouse receipt." J. Dingle, *Technical Selling in China*, at 36 (1974).

⁹ Smith, *Standard Form Contracts in the International Commercial Transactions of the People's Republic of China* 21 Int'l & Comp L. Quart 142 (1972).

¹⁰ Smith, for example, has "been told by British businessmen that in some cases of sales to the P.R.C. the letters of credit received only amount to 90 percent of the purchase price, and that the balance is sometimes used as a negotiating counter." *Id.* at 140.

¹¹ Bank of China Letter of Credit (on file with the author).

Considerable variation has occurred in the currency of payment employed. As in the case of Chinese exports, in recent years the Chinese have insisted on the use of their own currency as the medium of payment for their purchases. Recent contracts with foreign companies, however, have provided for payment in foreign currency, including U.S. dollars.

2. PAYMENTS UNDER TURNKEY CONTRACTS

The Chinese normally discharge their obligations under turnkey contracts by payment in cash. A typical contract may provide for payment of a total of 20 to 30 percent of the contract price at two stages prior to the first shipment of equipment, one at the signing of the contract, the other at an agreed-upon date some months thereafter. Most of the balance of the contract price would be paid as agreed-upon percentages of the invoice value of each shipment of equipment. The last two payments, often 5 percent each, would be paid respectively upon Chinese acceptance of the plant and expiration of the guaranty period. Another point at which payments might be made is upon the buyer's receipt of notification from the seller that the plant is ready for start-up.

The Chinese had long been known for their reluctance to purchase on credit terms except in the case of contracts for the purchase of agriculture commodities, which often provide for commercial credit up to 24 months. Since 1972, concurrently with the general increase in imports mentioned above, the Chinese have expressed a willingness to purchase whole plants on deferred payment terms. Most notably, the Chinese have purchased petrochemical plants from Japan on these terms. Several deferred payment contracts reportedly have provided for a downpayment of 20 percent, with the remainder payable at 6 percent over a 5-year period beginning with the completion of the plant. The Japanese Export-Import Bank, reversing a policy established in 1963, has begun to provide financing to manufacturers of goods exported to the P.R.C. to guarantee 80 percent of the annual obligation. Some purchases of plants from Western Europe also have been on a deferred payment basis, with equal guarantees furnished by Government export assistance programs in some cases.¹²

Chinese policy formerly emphasized unwillingness to borrow from abroad. At the same time, they demonstrated flexibility in using credit devices other than transactions clearly denominated as direct loans. According to one recent statement—

China is a country with neither internal nor external debts. As before, we will not accept foreign loans or incur external debts.

On the other hand, we will continue to use deferred payments, mutual deposit in banks and other practices customary in foreign trade and international finance.¹³

One device which has been used on occasion in the past has been supplier credit, in which a foreign bank finances a seller and is repaid

¹² For a table summarizing the terms of Chinese purchases of industrial plants and major components on a deferred payments basis during the period 1963 to September 1974, see Heymann, *Acquisition and Diffusion of Technology in China*, in *China: a Reassessment of the Economy*, Joint Economic Comm., 94th Cong., 1st sess., a Compendium of Papers 678, at 714-29. For a discussion of the technical but important question of calculation of the interest on deferred payments, see Dingle, *supra* note 8, at 30-31. Dingle indicates that the Chinese sometimes insist on paying interest on the face value of each payment rather than on the outstanding balances. *Ibid.*

¹³ "Deputy Director of Kwangchow Fair on China's Foreign Trade," *Economic Reporter* (No. 4, October-December 1977) at 10.

when it receives from the seller drafts drawn by it on letters of credit opened by the Bank of China. Under such arrangements of course, although the Chinese purchasers are purchasing on credit, the source is the seller and not the buyer, and the transaction is formally not a loan. However, presumably the cost of such a credit arrangement is reflected in the price of the goods. More recently, in the spring of 1978, Chinese trade and financial officials began to express to foreign visitors their willingness to borrow directly from foreign banks and consortia.

C. Barter

Barter and other arrangements for reducing cash obligations such as counter-purchase and payback in product have been employed only rarely in Sino-Western trade in recent years.¹⁴ In one barter transaction in 1973 when the Chinese purchased five sets of electrical generating equipment from a British company they reportedly paid for one with an assortment of products which included chemicals, food-stuffs and handicrafts. Generally, however, the Chinese have not favored barter because the products exchanged could be exported by foreigners to markets in which the bartered goods would compete with identical products sold by the P.R.C., usually at prices higher than the value assigned to them in a contract under which they were exchanged for goods.

D. Delivery

In contrast to the studied ambiguity of delivery dates in Chinese sale contracts, Chinese purchase contracts are quite exigent. A standard machinery import clause provides a penalty for late delivery which is fixed at a percentage of the contract price for each seven days up to a stated maximum, with a right given to the buyer to cancel the contract if delivery is delayed beyond 10 weeks.¹⁵ The maximum varies, but is usually no higher than 5 percent. Contracts for whole plants also contain stiff penalty provisions. Under the standard clauses, the Chinese seem to have the right to cancel the contract for any late delivery (unless the force majeure clause applies) and to exact the penalty as well.¹⁶ Sellers to the P.R.C. have had varying experiences under these clauses. Some, particularly steel sellers, have reported the Chinese to be unrelenting in their insistence that the penalty be paid. In other cases, the Chinese have agreed to extend the delivery time without a penalty, even though the clause did not specify a grace period. The difference may depend upon the need for the particular imports and also may be affected by the parties' prior relationship and the care with which the seller has documented the reason for the delay. In one case recounted to the author, the seller was also a buyer of Chinese exports who could point to frequently delayed Chinese deliveries which had caused him economic loss.

E. Force Majeure

Sellers frequently attempt to limit their liability for delayed delivery or non-delivery caused by acts over which they have no control,

¹⁴ On barter in Sino-Italian trade, see Reghizzi, *supra* note 5 at 111-12.

¹⁵ See, e.g., Machinery Contract, cl. 17.

¹⁶ See Smith, *supra* note 1, at 149.

while buyers are equally resistant to the efforts. The P.R.C. has a history of highly stubborn and successful buyer resistance; for example, the Chinese are reluctant to define in detail the circumstances that constitute force majeure. A standard machinery clause states that the seller is not liable for delay for non-delivery due to force majeure, but the term is not defined in the contract.¹⁷ The clause further requires the seller to notify the buyer immediately and follow that notification with "a certificate of the accident issued by the competent Government Authorities where the accident occurs."¹⁸ If the force majeure lasts for more than 10 weeks, the Chinese buyers have the right to cancel the contract.

Chinese corporations occasionally have agreed to specify some of the events which can be considered as instances of force majeure, such as "wars, or severe natural disasters."¹⁹ Other force majeure clauses have been even more specific, such as one which includes "war, earthquake, flood, fire, explosion and other force majeure circumstances agreed upon by both parties or approved by arbitration in the case of disagreement by both parties."²⁰ For ideological reasons the Chinese usually have been unwilling to specify "acts of God," labor unrest, or strikes as instances of force majeure.

Regardless of the language of the force majeure clause, in practice the Chinese appear willing to recognize the principle that an intervening act beyond the seller's control may excuse him from a penalty for the late delivery. Some clauses have mentioned "any other acts beyond the control of the sellers", and others have included a statement that the seller's liability for delay is to be limited as a result of "other unavoidable circumstances" agreed to by the parties after the seller has invoked the clause.²¹ Western European sellers who have had to invoke force majeure have stated that the Chinese generally have accepted the delay even though the actual cause was not specified in the contract.

F. Sellers' Guarantees: Inspection

Chinese insistence on purchasing the highest quality goods and holding sellers to the absolute letter of their agreement is partly reflected in a standard machinery import clause which requires that the seller:

[G]uarantee that the commodity is made of the best materials, with first class workmanship, brand new, unused and complies in all respects with the quality specifications and performance as stipulated in this Contract. The Sellers shall guarantee that the goods, when correctly mounted and properly operated and maintained, shall give satisfactory performance for a period of . . . months counting from the date on which the commodity arrives at the port of destination.²²

The guarantee period often extends to 12 or 18 months. Some negotiation is possible on the duration of the period and on when it begins to run (*i.e.*, from unloading at the port of destination or from arrival at the site).

¹⁷ Machinery Contract, cl. 16.

¹⁸ *Id.*

¹⁹ Reghizzi, *supra* note 5, at 110. This clause is drawn from a contract for the purchase of Italian goods, printed and completed in Peking. *Id.*

²⁰ *Id.* at 109.

²¹ For a general discussion of the vagueness of the force majeure clauses, see *id.* at 110. Reghizzi concludes that, "So far no problems . . . seem to have arisen, and the Chinese have recognized at least two cases of force majeure confirmed by a declaration of the Chamber of Commerce of Milan." *Id.*

²² Contract on file with the author. The clause in the machinery contract in the appendix omits the conditions of correct mounting and proper operation and maintenance. Machinery Contract, cl. 14.

Standard machinery clauses require the manufacturer to present a certificate of inspection regarding quality, specifications, performance and quantity, although the certificate is not considered final on those matters. The contract requires an additional inspection in China by the Commodity Inspection Bureau when the goods arrive. The standard clause provides that a claim may be asserted "on the strength of the Inspection Certificate" issued by the Bureau, "should the quality, specification or quantity be found not in conformity with the stipulations of the [c]ontract" within 90 days after arrival of the goods at the destination.²³ A claim also may be filed if the "damages occur in the course of operation by reason of inferior quality, bad workmanship or the use of inferior materials."²⁴

Other clauses are worded slightly differently and include "improper design, inferior quality, bad workmanship and the use of bad materials" as the basis for claims.²⁵ The sellers are responsible for "the immediate elimination of the defects[,] complete or partial replacement of the commodity" or for a partial refund of the contract price.²⁶

Even when contracts involve sales of whole plants or highly complex equipment, the Commodity Inspection Bureau also may be given a prominent role by the contract, although special tests out of the ordinary scope of the Bureau's activities may be involved. In such transactions, the standards which the plant or equipment must attain usually are derived from industrial standards common in the seller's business and are specified in detailed technical attachments to the contract. In contracts for the sale of whole plants, performance tests usually are carried out jointly under the instructions of the seller's personnel. Regardless of the standards used, inspections by the Chinese are rigorous.

Chinese practice has caused some difficulties for Western European and Japanese sellers, and can be expected to do the same in Sino-U.S. trade as well. So strict is Chinese insistence on adherence to the contract that several European manufacturers have been known to encounter Chinese complaints or even refusal to accept the goods when they shipped at no extra cost pieces of machinery that were newer models than those actually specified in the contract. Some European sellers have complained that sometimes the tests used by Chinese differ from the tests normally used in Europe. This difficulty perhaps may be prevented by specifying in the contract the relevant tests and standards which the Chinese will employ when the goods are delivered. In other cases the equipment may be so advanced that the Chinese lack the requisite technical expertise or highly sophisticated testing equipment. Compromise has been possible in these cases, but sometimes only with difficulty.

Additional contractual protection for the seller cannot be given by providing for joint inspection by representatives of the seller and buyer. Some turnkey contracts have specified that the Chinese may send their personnel to the seller's plant during delivery of the machinery. Clauses of this type, however, customarily state that the Chinese inspectors lack authority to countersign the certificates of

²³ Machinery Contract, cl. 15.

²⁴ *Id.*

²⁵ Smith, *supra* 9, at 147.

²⁶ Machinery Contract, cl. 15.

quality which the seller is obligated to supply. The clauses also explicitly state that the attendance of Chinese inspectors does not affect the seller's guarantee. Turnkey contracts also provide for the seller to send his own representatives to the plant site to inspect machinery and equipment at their delivery, although, again, his guarantee remains unaffected. Regardless of the inspection arrangements agreed to by the parties, it is most unlikely that the Chinese will give up their practice of subjecting imported machinery and equipment to strict inspection.²⁷

The experience of sellers under these clauses has lead many to marvel at the meticulousness of Chinese inspections and the particularity of Chinese claims. Where other buyers of vehicles are content to purchase small spare parts by volume, such as a kilogram of piston rings, the Chinese count them one by one; where other buyers of steel pipe X-ray the pipe at random for cracks, the Chinese may X-ray every inch and make claims for hairline cracks which most buyers will ignore. The seller must be prepared for extraordinarily detailed inspections and for some uncommon, perhaps minor, claims. U.S. sellers of machinery often state that this care is in principle no greater than that exercised by inspectors in sales to the U.S. Government and to many other governments.

Unfortunately, the present imperfect framework of Sino-Western trade rarely provides an easy opportunity for easily arranged, face-to-face contact between representatives of buyers and sellers and for informal claims settlement. Sending the seller's personnel to the site to engage in joint inspection with the Chinese personnel can at least help in this respect, although Chinese rigor in these matters apparently is not abated when arrangements have been made with European sellers. Bureaucratic considerations may significantly stimulate Chinese readiness to assert claims and reluctance to settle them: Chinese officials presumably are not eager to bear the responsibility for ordering or accepting delivery of defective goods from abroad, nor do they wish to be responsible for failing to assert a claim based on defects or for wrongly settling such a claim. As a result, negotiations by Western sellers who have dealt with the Chinese over a period of years sometimes are conducted against a background of unresolved claims previously asserted by the Chinese, which may serve as bargaining counters during negotiations on other contracts.

G. Dispute Settlement

Consistent with the tenacity with which Chinese assert and resist settlement of claims is their practice in settling foreign trade disputes. The Chinese have a record of energetically avoiding not only litigation but any third-party participation having overtones of adjudication. A standard clause provides that, "[a]ll disputes in connection with this Contract or the execution thereof shall be settled [amicably] through negotiations."²⁸ In the event that the negotiations fail, the parties

²⁷ In contracts for the sale of whole plants, the parties will have agreed on the performance tests that must be run, as well as on payment of penalties by the seller according to a sale "reflecting the importance of the failed parameter(s)." Dingle, *supra* note 8, at 45. The contracts usually allow the seller to repeat the test. But it has been observed that "[i]n practice, since the penalty scales representing payment as liquidated damages apply only to relatively small failures, significant discrepancies from guaranteed parameters such as output, product quality, and consumption of raw materials and utilities, will involve the Seller in making modifications theoretically without limit." *Id.* at 49.

²⁸ Machinery Contract, cl. 18.

are limited by this clause to arbitration before the Foreign Trade Arbitration Committee (FTAC) in Peking. Some sellers have been able to obtain Chinese consent to arbitration in Sweden or in Switzerland, and a recent contract with a U.S. seller reportedly has specified Canada as the arbitral forum. Sometimes the contract will simply provide that arbitration will be held in an unnamed third country to be agreed upon by the parties.²⁹ In recent years the Chinese have become more willing to specify a third country as the arbitral forum, and to specify the arbitral body and the rules applicable to the arbitration proceeding.³⁰

The Chinese long have expressed antipathy to choice-of-law clauses that subject any disputes to the rules of a designated foreign legal system, whether the seller's or that of a third country. Presumably, no legal system can be neutral, since the Chinese view law as an instrument by which ruling social classes maintain their dominance.³¹ In at least one recent transaction, however, a Chinese corporation not only agreed to arbitration before a named third-country body under International Chamber of Commerce rules, but also agreed that the contract would be governed by the law of that country. Nonetheless, no matter what the clauses on dispute settlement and the applicable law in the contract provide, the most significant aspect of Chinese practice on these matters is their determination to avoid arbitration altogether.

To date it has been impossible to obtain a detailed account of any trade arbitration involving a Chinese corporation.³² Some traders say that they will never ask for arbitration because they believe that the Chinese would consider the request to be "unfriendly," and that the request would endanger future business.³³ Other traders have said in private conversations that by either formally requesting or informally hinting that they were about to request arbitration they have brought about a prompt settlement. In other instances, however, the Chinese have been known not to respond at all. In one such case they are reported to have ignored the formal invocation of an arbitration clause

²⁹ Machinery Contract, cl. 20.

³⁰ This opinion is based on contracts which have been shown to the author and on conversations with Western businessmen and officials of the Legal Affairs Department of CCPIT.

³¹ See, e.g., Institute of Civil Law of the People's Republic of China, Central Political-Legal Cadres School, *Basic Problems in the Civil Law of the People's Republic of China* 8 (Chung-Hua Jen-Min Kung-Ho Kuo Min-Fa Chi-Pen Wen-T'i, 1958), U.S. Joint Publications Research Service No. 4879 (1961): "Marxism-Leninism has always maintained that both law and jurisprudence possess a very intensive class character and can only serve the ruling class of a given period."

³² Representatives of the American Arbitration Association were told that in 1974 over 100 cases that were brought to the attention of the FTAC were settled by "friendly negotiations," while 12 were settled on the basis of "non-binding recommendation" made by the FTAC, and only two cases in 1974 were settled by formal FTAC arbitration. Holtzmann, *Resolving Disputes in U.S.-China Trade*, in *LEGAL ASPECTS OF U.S.-China Trade* 77 (H. Holtzmann, ed. 1975). The Holtzmann account offers a fascinating recapitulation of the Chinese emphasis on avoiding arbitration and on maintaining fluid and informal devices for disputes settlement.

For a recent Chinese view, see *Primer on International Trade* (translation of Writers Group of the Foreign Trade Department of the Liaoning Fiscal Institute, *Primer on International Trade*), 8 Chinese Economic Studies, Winter 1974-75, at 32-33.

Cases conducted within the arbitration systems of capitalist countries are usually not public, and the written rulings more than half the time do not give reasons for the decisions made. Our nation's foreign trade arbitration system operates in accordance with the "Temporary Rules of the Foreign Trade Arbitration Committee of the Chinese Council for the Promotion of International Trade."

Unless the parties involved in the dispute demand otherwise, the cases are heard publicly. Reasons are always given for the rulings. Moreover, our country's foreign trade arbitration system relies on a spirit of cooperation between arbitration and mediation. We try whenever possible to solve disputes through mediation, doing everything we can do to help the two sides reach an agreement through the principles of negotiation and voluntarism and, by reaching an amiable settlement, promote the development of mutual trade.

³³ Reghizzi indicates that "[e]ven the suggestion that a dispute be submitted to arbitration in Peking is met with disfavor." Reghizzi, *Law and Sino-Italian Trade*, in *Law and Politics in China's Foreign Trade* 184 (V. Li ed. 1977).

while continuing to correspond with the European seller involved on all matters other than arbitration; eventually the claim was compromised. Moreover, some sellers who have negotiated a Chinese claim feel that in order to preserve the air of compromise they were forced to yield to some extent even when they were convinced that the claim was groundless or exaggerated.³⁴

Another illustration of the Chinese preference for non-adjudicated dispute settlement, which has recently received attention in a Sino-U.S. dispute, is a strong emphasis on conciliation. An authoritative Chinese statement on the subject reads:

"In concrete work, the [Foreign Trade Arbitration Commission] and the [Maritime Arbitration Commission] adopt the method of combining arbitration with conciliation . . . Experience proves that most of the cases . . . can be settled by conciliation in the course of investigation or examination, prior to the arbitration proceedings or before an award is granted" ³⁵

Recently, a dispute between an American commodities seller and a Chinese buyer was resolved through a form of conciliation devised by the Legal Department of the China Council for the Promotion of International Trade and by the American Arbitration Association. Conciliators appointed by the two parties met in Peking in October, 1977, and arrived at a mutually satisfactory basis for resolution of the agreement in the course of a ten-day period.³⁶

The cooperation between the Chinese and U.S. sides is innovative and encouraging. However, it should be realized that the more institutionalized conciliation becomes, the greater the difficulties are likely to be encountered by the American disputant who wishes to stop negotiating and bargaining over the terms of a settlement and wants to proceed to a definitive third-party adjudication. At any rate, this recent case of joint conciliation is a development that American and other foreign sellers should watch with interest.

Improvisation of bilateral efforts to settle trade disputes offers considerably more hope for reaching solutions satisfactory to the American side than the unrealistic suggestion that the United States and the P.R.C. should agree that "legal and natural persons ought to have access to the domestic courts of the two countries."³⁷ Not only do U.S. corporate counsel not know enough about the Chinese legal system to enable them to decide whether they want to seek remedies in Chinese courts, but the considerable amount of general information available on the Chinese legal system suggests that the basic assumptions underlying that system are too different, and its rules too indefinite and difficult to ascertain, for U.S. sellers realistically to prefer Chinese domestic courts to Chinese or third-country trade arbitration. The Chinese have avoided using courts to settle trade disputes, a preference that helps to explain the creation of Chinese trade arbitration bodies. Moreover, it is highly unlikely that the Chinese corporations would want access to U.S. courts; lawsuits initiated by Chinese commercial entities in any foreign court since 1949 are extremely rare. On balance, U.S. sellers and their advisers, while seeking to

³⁴ *Ibid.*

³⁵ Jen Tsien-Hsin and Liu Shao-Shan, "Arbitration in China", p. 3 (mimeographed copy given to the author in Peking in March, 1978).

³⁶ *China Business Review*, Nov.-Dec., 1977

³⁷ Theroux, *Legal and Practical Problems in the China Trade*, China: A Reassessment of the Economy Joint Economic Comm., 94th Cong., 1st sess., A Compendium of Papers 533, 588 (1975).

devise novel methods of bilateral dispute settlement, are also advised to continue probes and general discussions and, like European veterans of trade with the P.R.C., to press for third-country arbitration.

H. Industrial Property

1. PATENTS AND KNOW-HOW

Contract clauses on protection of foreign patents and know-how in the P.R.C. are particularly important since there is no Chinese statutory scheme for their protection. A P.R.C. statute permits P.R.C. citizens or foreign individuals or groups to register invention and receive cash awards,³⁸ but all inventions, apparently including those unregistered, become the property of the P.R.C. Accordingly, the only way a foreign seller can protect his rights in his industrial property is by bargaining for a contract clause that will afford him protection.

The China National Technical Import Corporation, which negotiates for the purchase of whole plants, is likely to be involved in negotiating the clause. In a few rare occurrences, the Technical Import Corporation has purchased technology without also buying equipment, as when it negotiated with the Berliet Company of Paris for licenses to manufacture trucks. Generally, however, purchases of technology occur in the context of a whole-plant purchase. Practice apparently varies on whether the license has a specified portion of the contract price assigned to it, or whether it is included in that price,³⁹ but there apparently are never any payments of royalties. The provisions covering patents and knowhow make the agreement a lump-sum sale. The actual payments may be completed at the time the plant begins operations or may be included in the installments paid under deferred payment terms.

The foreign seller of technology must rely on the contract to protect him against use of his industrial property in ways extending beyond the scope of the contract, either by Chinese duplication of it or by Chinese disclosure or subsequent unlicensed transfer. Officials of the CCPIT Legal Affairs Department with whom this question has been discussed have acknowledged that the Chinese side must be willing to provide the protection, and the Technical Import Corporation, which has negotiated licenses with foreign licensors, has concurred. In some contracts, the Technical Import Corporation has agreed never to disclose the licensed technology; in other contracts nondisclosure has been limited to a period of years. The original license usually assumes a fixed periodic output at a disclosed number of plants, but the Chinese sometimes wish to use the licensed process in other plants. In varying language the Technical Import Corporation has agreed not to duplicate a plant utilizing the process covered by a license, subject to a Chinese right to improve the plant or plants covered by the license and to increase production at those plants without any obligation to the seller. The Technical Import Corporation at times has sought to obtain the licensor's approval of unlimited

³⁸ Regulations of Nov. 3, 1963. Concerning Awards for Inventions, [1964] 13 *Chung-Hua Jen-Min Kung-Ho-Kuo Fa-Kuei Hui-Pien* [FKHP] (Compilation of Laws and Regulations of the Peoples' Republic of China 241. For English translation, see U.S. Consulate, Hong Kong, Survey of the China Mainland Press, No. 3117, Dec. 11, 1963 at 6.

³⁹ This variation has been described to the author in private conversation with representatives of European and American companies who have discussed licensing with the Technical Import Corporation. It has also been reported in *How China Buys Foreign Technology*, *Bus. Int'l*, Dec. 5, 1972, at 396.

use of the licensed technology. One licensor retained the technology for production of a vital catalyst, and can measure Chinese production by their purchases of the catalyst from the licensor.

Consistent with its preference for lump-sum purchases, the Technical Import Corporation often has been willing to forego the right to make use of future improvements of a process by the licensor if further payments would be required. Certain licensing agreements, however, require the licensor to continue to inform the Chinese licensee of improvements for a stated period of time, often as a minimum until the plant begins operations. On the other hand, the Technical Import Corporation has been unwilling to agree to disclose subsequent Chinese improvements.

Foreign sellers often seek to prohibit the P.R.C. from exporting products manufactured by the plants. It is difficult to determine how readily the Technical Import Corporation will agree to this restriction. The author has been informed that in at least one agreement with a Japanese licensor, the Corporation has agreed that the products would not be exported.

2. TRADEMARKS

Although no known contract has involved the use of a foreign trademark in the P.R.C., Chinese legislation on trademarks has created a framework for dealing with this type of industrial property.⁴⁰ A Chinese statute specifically permits a foreign enterprise to register marks to which it has rights in its own country⁴¹ if that country has reached an agreement with the P.R.C. on the reciprocal recognition of trademarks.⁴² Nationality of the applicant appears to be the governing criterion of belonging to a foreign country.⁴³ The precise language of the statute suggests that it may be possible for protection to be given to an applicant from a country that has not formally concluded an agreement, but that protects Chinese trademarks by virtue of its own laws, as is the case with the United States.⁴⁴

Indeed, early in 1978 the Chinese government announced that registration of foreign trademarks in Peking would be permitted according to the principle of reciprocity. As a result, U.S. trademarks may now be registered in Peking, although the United States and China have not concluded an agreement on the subject. Similarly, this writer has been informed that reciprocity will determine other aspects of registration. Formerly, for instance, registrants in Peking had to file copies of their original certificates of registration, but now that requirement will be dispensed with whenever it would not be imposed on foreign applicants by the registrant's country.

Invocation of reciprocity by the Chinese in trademark matters has a variety of implications. Obviously it will interest U.S. manufacturers who are zealous about extending protection of their often very highly valuable trademarks. In addition, this development may reflect the

⁴⁰ For a discussion of China's application of trademark laws and regulations, see Randt, *Trademark Law in the PRC: Case Files with Morals for Western Traders*, U.S.-China Bus. Rev., May-June 1974, at 3.

⁴¹ Regulations of Apr. 10, 1963, Concerning the Control of Trademarks, [1964] 13 FKHP 162 [hereinafter cited as Regulations on Control of Trademarks]; Rules of Apr. 25, 1963, Concerning the Implementation of the Regulations Governing the Control of Trademarks, [1964] 13 FKHP 164.

⁴² Regulations on Control of Trademarks, § 12(1).

⁴³ See Implementing Regulations, *supra* note 41 at §§ 16, 20. These regulations make specific reference to the "certificate of nationality" which foreign enterprises must file. *Id.*

⁴⁴ It should be noted that the registration process is simple and inexpensive, consisting of filing a single application with the Legal Affairs Department of CCPIT, which must be given a power of attorney by a notarized document. The fee for registration is a nominal RMB 20, approximately \$12.00 at the rate of exchange prevailing in late May, 1978.

interest of Chinese trade corporations in protecting their own trademarks, particularly since some of them are exporting products bearing brand names used in China before 1949, and that are now being used by the former owners doing business from Taiwan. The Chinese action also raises another interesting question: does invocation of international reciprocity reflect increased Chinese interest in international legal practice? Recent emphasis throughout China on developing domestic legal institutions suggests that Chinese interest in formal legal institutions has noticeably increased.

III. RECENT DEVELOPMENTS IN CHINESE POLICIES TOWARD LAW

For over twenty years formal legal institutions have had little importance in China.⁴⁵ From 1949 to 1957 China experimented, with varying degrees of commitment and intensity, with a legal system based on that of the Soviet Union. A three-tiered judicial system was established, law schools began to train the nucleus of a small bar, and attempts were made to institutionalize substantive and procedural rules. These activities were repeatedly interrupted by wave after wave of mobilizational social and economic change which destroyed landlords and urban bourgeoisie alike and brought about the socialization of China's economy.

Throughout these early years, certain conflicts over basic ideas of leadership, administration and policy-implementation remained unresolved in the legal system. The relative roles of objective standards as against the subjective judgements of administrative cadres, rules rather than persuasion, legal specialists rather than political generalists, were not clearly defined. Yet as part of the drive to industrialize China the framework of a modern legal system was established, some legal specialists were trained, and many laws and regulations were promulgated. By 1956 work was begun on law codes, several legal periodicals were publishing regularly, and the small bar was beginning to become active.

However, attempts to regularize and expand the legal system fountained in 1957, when China's leaders, greatly concerned at the vehemence of much of the criticism that was expressed during the "Hundred Flowers" of 1956-1957, launched a campaign against "rightism". Among the chief targets of the campaign were the legal specialists and the codes and objective standards they had favored. The specialists had complained at the gaps in the law, the failure to

⁴⁵ It is impossible in the brief space available to trace the complicated history of Chinese policies toward law. The interested reader would be well advised to consult an excellent overview, Victor H. Li, *Law Without Lawyers* (1977). The roots of the Chinese Communist policies toward law lie in the history of the Chinese Revolution itself. See e.g., S. Leng, *Justice in Communist China 1-76* (1967). For a broad interpretation of Chinese Communist attitudes toward law, see Li, *The Role of Law in Communist China*, *China Q.*, Oct.-Dec. 1970, at 66.

On criminal law, J. Cohen, *The Criminal Process in the People's Republic of China 1948-1963* (1968), contains many translations of Chinese materials and a useful chronological discussion and an analysis of developments in the Chinese legal system to the mid-1960's. For other work on Chinese criminal law, see Li, *The Evolution and Development of the Chinese Legal System*, in *China: Management of a Revolutionary Society* 221 (J. Lindbeck, ed. 1971); Lubman, *Form and Function in the Chinese Criminal Process*, 69 *Colum. L. Rev.* 535 (1969).

No general Western language text or collection of materials on civil law has yet been published. For selected civil law topics, see Lubman, *Methodological Problems in Studying Chinese Communist "Civil Law"*, in *Contemporary Chinese Law; Research Problems and Perspectives* 230 (J. Cohen ed. 1970); Huang, *Reflections on Law and the Economy in the People's Republic of China*, 14 *Harv. Int'l L. J.* 261-285, 89 (1973); Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 *Calif. L. Rev.* 1284 (1967); Pfeffer, *Contracts in China Revised, With a Focus on Agriculture, 1949-63*, 28 *China Q.* 106 (1966).

make progress on the new codes, and the disregard of established laws and procedures by many cadres. As a result of the campaign many legal specialists lost their jobs, codification projects were suspended, and the content of legal curricula was greatly politicized.

Since 1957 the courts have been little used in China, most of the few thousand lawyers trained before then were assigned to other jobs, and some functions of the courts such as sanctioning for minor offenses were distributed to the police, to local neighborhood organizations in the cities and lower levels of the rural communes, and to work units such as factories and offices. The procuracy, a prosecutorial institution established during the nineteen-fifties, disappeared.

The Cultural Revolution saw yet further attacks on the formal legal system, including the police, which was for years supplanted by the People's Liberation Army in its role of maintaining public order. During the early nineteen-seventies the police reappeared, the law courts were occasionally mentioned in the press, and at least one law department, at Peking University, began to be more active again. However, not until early 1978 has law been prominently mentioned, either in the sense of denoting a set of desirable institutions or as an academic discipline. In the wake of the overthrow of the "Gang of Four", as China's leadership firmly attempts to set China upon a course of economic modernization, it has obviously given thought to using law to strengthen China's administrative system.

In March, 1978, a new Constitution was adopted by the Fifth National People's Congress. Although like other Chinese constitutions it is both a programmatic statement as well as a framework for the structure of the Chinese state, it contains separate sections devoted to the courts and to the newly reappeared procuracy, and to citizens' fundamental rights. In addition, strong signs have appeared of a leadership policy to reconstruct and develop China's legal institutions.

In February, 1978, it was announced that the newly-established Chinese Academy of Social Sciences included a Law Institute, which was going to offer graduate courses. Han Yu-t'ung, the Deputy Director of the new Institute, has since made several interesting statements which apparently reflect official policy. In an interview in late February she accused the "Gang of Four" of having sabotaged the police and the courts, and stressed the need to follow orderly procedures in handling criminal cases.⁴⁶

Notably, on March 16, 1978 Han Yu-t'ung published an important article in the People's Daily entitled "Smash Spiritual Shackles—Do Legal Work Well",⁴⁷ the article calls for law-making and discipline according to law in terms that have not been used in China for many years. The article blames the failure to formulate necessary laws and to revise others on the "Gang of Four"; some observers would trace the deemphasis of law farther back, as has been suggested above. More striking than the focusing of blame for neglect of law, however, is the call for new activity.

The article says that Chairman Mao himself stated in 1962 that "it won't do to have no law", and a program of law-making is proposed:

⁴⁶ "Deputy Director of Law Institute Discusses Socialist Legality", People's Republic of China Mission to the United Nations Press Release No. 12, 21 Feb. 1978.

⁴⁷ *People's Daily*, Peking, March 16, 1978, p. 3.

"To strengthen socialist legality", the article says, "we must first of all proceed with legislative work on a large scale." To do this, "necessary legal organs and legal institutions must be revived and established", and legislation on "criminal law, criminal procedure, civil law and civil procedure" should be enacted, as well as "important laws on economic construction". Much revision of existing law is necessary, as well as strengthening of existing legal organs. In addition, "leading organizations and leading cadres must become models in carrying out and following the constitution and the law." The article called also for developing popular education about legality on a large scale throughout the media.

The article signifies an end to the long hiatus in Chinese law-making, and suggests that China's leaders are beginning to stress the importance of regularized rules for China's current modernization efforts. The link between law-making, law observance and the education of cadres and masses is also significant because officials and population alike have in the past often been encouraged to be impatient with rules and regulations. Recent signs that the new policy is being implemented were apparent when this author visited Canton in April, 1978: A statute originally promulgated in 1957, providing for police punishment of minor violations of public order, had been promulgated and posted in downtown Canton; outside the offices of a neighborhood residents' committee a poster urged all to support Chairman Huá's call to strengthen the socialist legal system.

Even more recently, *Red Flag*, the Chinese Communist Party's theoretical monthly, featured an article by Chiang Hua, President of the Supreme People's Court, calling for enforcement of the new constitution and for improvement of the legal system.⁴⁸ Emphasis is laid on the need for cadres to obey the law and party discipline, and on protection of persons who "expose bad persons and deeds in state institutions." The need for orderly and regularized judicial procedure is explicitly recognized. Elsewhere, authoritative statements by local leaders⁴⁹ and in the media have echoed the themes articulated in Han Yu-t'ung's article summarized above.⁵⁰

Although the emphasis on legality has been expressed only very generally and very recently, its reappearance in China is noteworthy and invites speculation on its significance. It certainly suggests that the Chinese leadership is committed to orderly, structured leadership and administration of economic development. To some extent socialist legality will probably be used to reinforce discipline, as it was during the mid nineteen-fifties, the last time heavy industrialization, constitutionalism and the rule of law were simultaneously stressed in China.

But the language of the most recent Chinese articles also suggests that the making and application of rules and regulations may be used soon to systematize China's apparatus of government. Conversations with legal specialists in Peking in March 1978 suggested that codification projects would be resumed and that many laws would be revised and harmonized. Han Yu-t'ung's article specifically mentioned the need for "important laws on socialist construction". Since 1949 great quantities of internal bureaucratic regulations have been promulgated

⁴⁸ Red Flag on New Constitution, Socialist Legal System, FBIS Daily Report, China, 11 May 78, p. E7.

⁴⁹ See, e.g., "Kiangsu Meeting on Public Security, Judicial Work in Nanking", FBIS Daily Report, China, 10 May 78, p. G4.

⁵⁰ "Call for Rule of Law" [Report on *Liberation Army Daily* 7 May Editorial: "Be Models in Abiding by the Constitution and Obeying the Rule of Law", FBIS Daily Report, China, 10 May 78, p. E 10.

to direct the activities of economic units and their relations with each other. China's current modernization drive could well produce legislation expressing general principles of economic administration that until now have not been articulated. Legal and economic planning officials stated in July 1978 that drafts of such principles were being circulated internally.

Much more difficult to predict is the significance, if any, of the domestic emphasis on legality for China's international economic relations. Can the new attention to legality at home in any way be a harbinger of increased Chinese interest in international trade law and practice? Perhaps it is not coincidental that Chinese invocation of the principle of reciprocity in trademark registration, noted above, should come at this time. It is too early to tell. At the moment, no direct relationship can be ascertained between China's domestic legality and international trade practice—but the strengthening of legality may reflect a cast of mind and a relative doctrinal openness that could lead to receptivity to new ideas and to flexibility in foreign trade. Of interest in this regard is an apparent increase in the number of lawyers' delegations being invited to China. A Canadian bar delegation visited China in early 1978, and two groups from the American Bar Association were scheduled to visit China in 1978. The first, led by Association President William A. Spann, Jr. in July, which apparently was allowed to learn more about Chinese legal institutions than previous visitors, traveled as official guests of the China People's Friendship Association. This delegation was told by high-ranking officials that law codes were being prepared, and throughout the visit the regular operation of the formal legal system was emphasized.

Whether increased contacts with foreign lawyers will eventually influence Chinese negotiating practice and contracts is of course impossible to predict. Negotiations of the type described at the beginning of this essay have usually been conducted without significant reference to practice and precedents other than those of the Chinese trade corporation involved. It is not impossible these days to invoke and discuss conventional international practice in some matters, although obtaining the assent of Chinese negotiators to change contract language that has long been in use is, as anywhere else in the world in similar situations, difficult. Yet if the emphasis on legality and the new attention to law are continued, it may be that Chinese practice in international trade will also reflect the influence of the new policy. As China imports more technology and licensors insist on a more evident willingness to protect patents and know-how, China may show greater interest in the international patent system. In this manner changes in domestic development policy may cause China to move closer to formal adherence to prevailing norms of international trade law. In the meantime, current policies suggest that Chinese legal institutions may be reemerging as significant components of the Chinese State.

APPENDIX

CONTRACT

No. _____
Peking, Date _____

The buyers:

China National Machinery Import and Export Corporation, Erh-Li-Kou, Hsi Chiao, Peking, China. (Cable Address: "Machimpex" Peking)

The Sellers:

This Contract is made by and between the Buyers and the Sellers; whereby the Buyers agree to buy and the Sellers agree to sell the undermentioned commodity according to the terms and conditions stipulated below:

1. *Commodity, Specifications, Quantity and Unit Price:*
2. *Total Value:*
3. *Country of origin and Manufacturers:*
4. *Packing:* To be packed in strong wooden case(s) or in carton(s), suitable for long distance ocean parcel post air freight transportation and to change of climate, well protected against moisture and shocks. The Sellers shall be liable for any damage of the commodity and expenses incurred on account of improper packing and for any rust attributable to inadequate or improper protective measures taken by the Sellers in regard to the packing. One full set of service instructions for each instrument shall be enclosed in the case(s).
5. *Shipping Mark:* The Sellers shall mark on each package with fadeless paint the package number, gross weight, net weight measurement and the wordings: "Keep Away From Moisture", "Handle With Care", "This Side Up" etc., and the shipping mark:
6. *Time of Shipment:*
7. *Port of Shipment:*
8. *Port of Destination:*
9. *Insurance:* To be covered by the Buyers after shipment.
10. *Payment: for/by*
 - (1) In case by L/C: The Buyers, upon receipt from the Sellers of the delivery advice specified in Clause 12 (1)(a) hereof, shall 15-20 days prior to the date of delivery, open an irrevocable Letter of Credit with the Bank of China, Peking, in favour of the Sellers, for an amount equivalent to the total value of the shipment. The Credit shall be payable against the presentation of the draft drawn on the opening bank and the shipping documents specified in Clause 11 hereof. The Letter of Credit shall be valid until the 15th day after the shipment is effected.
 - (2) In case by Collection: After delivery is made, the Sellers shall send the shipping documents specified in Clause 11 hereof, from the Sellers' Bank through Bank of China, to the Buyers for collection.
 - (3) In case by M/T or T/T: Payment to be effected by the Buyers within seven days after receipt of the shipping documents specified in Clause 11 of this contract.
11. *Documents:* The Sellers shall present to the paying bank the following documents for negotiation:
 - (1) In case by freight:
 - 3 Negotiable copies of clean on broad ocean Bill of Lading marked "Freight To Collect"/"Freight Prepaid", made out to order, blank endorsed, and notifying the China National Foreign Trade Transportation Corporation at the port of destination.
 - In case by air freight:
 - One copy of Airway Bill marked "Freight Prepaid" and consigned to the Buyers.
 - In case by post:
 - One copy of Parcel Receipt addressed to the Buyers.
 - (2) 5 copies of Invoice with the insertion of Contract No. and the Shipping Mark. (in case of more than one shipping mark, the invoice shall be issued separately).
 - (3) 2 copies of Packing List issued by the Manufacturers.
 - (4) 1 copy of Certificate of Quantity and Quality issued by the Manufacturers.
 - (5) Certified copy of cable/letter to the Buyers, advising shipment immediately after shipment is made.
 - (6) The Sellers shall, within 10 days after the shipment is effected, send by air-mail two sets of the abovementioned documents (except Item 5)-One set to the Buyers and the other set to the China National Foreign Trade Transportation Corporation at the port of destination.
 12. *Shipment:*
 - (1) In case of FOB Terms:
 - a. The Sellers shall, 30 days before the date of shipment stipulated in the Contract, advise the Buyers by cable/letter of the Contract No., commodity, quantity, value, number of package, gross weight and date of readiness at the port of shipment for the Buyers to book shipping space.

b. Booking of shipping space shall be attended to by the Buyers' Shipping Agents Messrs. China National Chartering Corporation, Peking, China. (Cable address: Zhongzu Peking)

c. China National Chartering Corporation, Peking, China, or its Port Agents, (or Liners' Agents) shall send to the Sellers 10 days before the estimated date of arrival of the vessel at the port of shipment, a preliminary notice indicating the name of vessel, estimated date of loading, Contract No. for the Sellers to arrange shipment. The Sellers are requested to get in close contact with the shipping agents. When it becomes necessary to change the carrying vessel or in the event of her arrival having to be advanced or delayed the Buyers or the Shipping Agent shall advise the Sellers in time. Should the vessel fail to arrive at the port of loading within 30 days after the arrival date advised by the Buyers, the Buyers shall bear the storage and insurance expenses incurred from the 31st day.

d. The Sellers shall be liable for any dead freight or demurrage, should it happen that they have failed to have the commodity ready for loading after the carrying vessel has arrived at the port of shipment on time.

e. The Sellers shall bear all expenses, risks of the commodity before it passes over the vessel's rail and is released from the tackle. After it has passed over the vessel's rail and been released from the tackle, all expenses of the commodity shall be for the Buyers' account.

(2) In case of C&F Terms:

a. The Sellers shall ship the goods within the shipment time from the port of shipment to the port of destination. Transshipment is not allowed. The contracted goods shall not be carried by a vessel flying the flag of the country which the Buyers can not accept. The carrying vessel shall not call or stop over at the port/ports of Taiwan and/or the port/ports in the vicinities of Taiwan prior to her arrival at the port of destination as stipulated in Clause 8 of this Contract.

b. In case the goods are to be dispatched by parcel post/air-freight, the Sellers shall, 30 days before the time of delivery as stipulated in Clause 6, inform the Buyers by cable/letter of the estimated date of delivery, Contract No., commodity, invoiced value, etc. The sellers shall, immediately after dispatch of the goods, advise the Buyers by cable/letter of the Contract No., commodity, invoiced value and date of dispatch for the Buyers to arrange insurance in time.

13. *Shipping Advice:*

The Sellers shall, immediately upon the completion of the loading of the goods, advise by cable/letter the Buyers of the Contract No., commodity, quantity, invoiced value, gross weight, name of vessel and date of sailing etc. In case the Buyers fail to arrange insurance in time due to the Sellers not having cabled in time, all losses shall be borne by the Sellers.

14. *Guarantee of Quality:*

The Sellers guarantee that the commodity hereof is made of the best materials with first class workmanship, brand new and unused, and complies in all respects with the quality and specification stipulated in this Contract. The guarantee period shall be 12 months counting from the date on which the commodity arrives at the port of destination.

15. *Claims:*

Within 90 days after the arrival of the goods at destination, should the quality, specification, or quantity be found not in conformity with the stipulations of the Contract except those claims for which the insurance company or the owners of the vessel are liable, the Buyers shall, on the strength of the Inspection Certificate issued by the China Commodity Inspection Bureau, have the right to claim for replacement with new goods, or for compensation, and all the expenses (such as inspection charges, freight for returning the goods and for sending the replacement, insurance premium, storage and loading and unloading charges etc.) shall be borne by the Sellers. As regards quality, the Sellers shall guarantee that if, within 12 months from the date of arrival of the goods at destination, damages occur in the course of operation by reason of inferior quality, bad workmanship or the use of inferior materials, the Buyers shall immediately notify the Sellers in writing and put forward a claim supported by Inspection Certificate issued by the China Commodity Inspection Bureau. The Certificate so issued shall be accepted as the base

of a claim. The Sellers, in accordance with the Buyers' claim shall be responsible for the immediate elimination of the defect(s), complete or partial replacement of the commodity or shall devalue the commodity according to the State of defect(s). Where necessary, the Buyers shall be at liberty to eliminate the defect(s) themselves at the Sellers' expenses. If the Sellers fail to answer the Buyers within one month after receipt of the aforesaid claim the claim shall be reckoned as having been accepted by the Sellers.

16. Force Majeure:

The Sellers shall not be held responsible for the delay in shipment or non-delivery of the goods due to the Force Majeure, which might occur during the process of manufacturing or in the course of loading or transit. The Sellers shall advise the Buyers immediately of the occurrence mentioned above and within fourteen days thereafter, the Sellers shall send by airmail to the Buyers for their acceptance a certificate of the accident issued by the Competent Government Authorities where the accident occurs as evidence thereof.

Under such circumstances the Sellers, however, are still under the obligation to take all necessary measures to hasten the delivery of the goods. In case the accident lasts for more than 10 weeks, the Buyers shall have the right to cancel the Contract.

17. Late Delivery and Penalty:

Should the Sellers fail to make delivery on time as stipulated in the Contract, with exception of Force Majeure causes specified in Clause 16 of this Contract, the Buyers shall agree to postpone the delivery on condition that the Sellers agree to pay a penalty which shall be deducted by the paying bank from the payment under negotiation. The penalty, however, shall not exceed 5% of the total value of the goods involved in the late delivery. The rate of penalty is charged at 0.5% for every seven days, odd days less than seven days should be counted as seven days. In case the Sellers fail to make delivery ten weeks later than the time of shipment stipulated in the Contract, the Buyers shall have the right to cancel the contract and the Sellers, in spite of the cancellation, shall still pay the aforesaid penalty to the Buyers without delay.

18. Arbitration:

All disputes in connection with this Contract or the execution thereof shall be settled through friendly negotiations. In case no settlement can be reached, the case may then be submitted for arbitration to the Arbitration Committee of the China Council for the Promotion of International Trade in accordance with the Provisional Rules of Procedures promulgated by the said Arbitration Committee. The Arbitration shall take place in Peking and the decision of the Arbitration Committee shall be final and binding upon both parties; neither party shall seek recourse to a law court or other authorities to appeal for revision of the decision. Arbitration fee shall be borne by the losing party. Or the Arbitration may be settled in the third country mutually agreed upon by both parties.

19. Special Provisions:

In Witness Whereof, this Contract is signed by both parties in two original copies; each party holds one copy.

The Buyers:
China National Machinery Import
and Export Corporation

The Sellers: