Legal and Institutional Uncertainties in the Domestic Contract Law of the People's Republic of China

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This article attempts to link characteristics of Chinese contracts to the specific idcological, legal and institutional arrangements that govern them. In the context of Hong Kong's reversion to Chinese sovereignty, this analysis of the domestic law of the People's Republic of China may now have important implications for Hong Kong.

Since Chinese scholars often trace peculiarities in China's contract law to the pre-1980 planned economy, the article begins by rehearsing key characteristics of contracts under planning. After a brief analysis of the function of post-Mao legal reform, of the civil law, and of the relations between the legislature, judiciary, and Communist Party, the article examines, in turn, three stages of the contractual process: (1) On capacity, the author maintains that economic contracts are still restricted to "juristic persons" (*faren*), and that this empowers the state to "screen" economic actors. (2) On formation and performance, the author argues that "liberalizing" changes implemented by the 1993 Economic Contract Law still leave the state considerable "principled ambiguity" to interfere. Moreover, Chinese versions of liquidated damages, anticipatory repudiation, *force majeure*, and the absence of *rebus sic stantibus* all reflect vestiges of the planned economy's emphasis on specific performance. (3) On dispute resolution, the author discusses mediation, resolution by a common superior, arbitration, and the courts..He stresses control of mediation by the state, and the tendency for mediation to blur into arbitration; the influence on courts from local cadres and the Ministry of Justice; and the inability of the judiciary to form an internally consistent, self-referential corpus of case law.

This analysis concludes that despite the importance of legal reform (*viz.*, a prospective "unified" contract law), real private-law proteetion for contracts will require a fundamental rethinking of the institutional arrangements which make up party-state rule.

Le présent article vise à expliquer certains principes du droit chinois des contrats à la lumière de leur contexte idéologique, légal et institutionnel. Au moment du retour de Hong-Kong à la Chine, cette analyse pourrait avoir des conséquences importantes pour tous ceux qui font affaires à Hong-Kong.

La plupart des juristes chinois expliquent les particularités du droit chinois des contrats à partir de l'économie planifiée d'avant 1980. L'auteur débute donc par une analyse des contrats dans une économie planifiée. Après une brève analyse de la réforme du droit civil dans l'ère post-Mao et des relations entre la législature, le système judiciaire et le parti communiste, l'article explore une à une trois étapes du processus contractuel. (1) À propos de la capacité, l'auteur note que les contrats à caractère économique demeurent l'apanage des «personnes juridiques» (*faren*) et que cela permet à l'État de sélectionner les acteurs économiques. (2) À propos de la formation et de l'exécution, l'auteur affirme que les réformes «libérales» mises en place par la *Loi sur les contrats de 1993* laissent à l'État une marge d'intervention importante. (3) À propos de la résolution de différends, l'auteur discute de la médiation, de la résolution «interne» des conflits, de l'arbitrage et du recours judiciaire. Il souligne l'importance du contrôle exereé sur la médiation par l'État et la tendance de la médiation à se muer en arbitrage, ainsi que l'influence des cadres locaux et du ministère de la justice sur les tribunaux et l'impossibilité pour les tribunaux de former un corps de décisions qui soit cohérent et qui démontre une certaine logique interne.

Cette analyse conclut que malgré l'importance de la réforme légale (soit la possibilité d'un droit «unifié» des contrats), une protection réelle des contrats en droit privé chinois exige une réforme en profondeur des arrangements institutionnels qui sont à la base de l'État à parti unique.

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Introduction

In the wake of Hong Kong's handover to the People's Republic of China ("P.R.C.") on 1 July 1997, foreign business and political leaders will be monitoring Hong Kong's legal protection of commercial contracts for signs of mainland influence. Western business executives say that a contract in the P.R.C. is "more a sense of moral obligation than absolute rights", "vaguely worded mush", "arbitrary justice", and "a piece of wastepaper".[1] Lack of enforcement is written off as "part of the cost of doing business" while editorialists admonish China to start following the "rules of the road".[2] This study aims to shed light on how the legal and institutional milieu in which contracts function in the P.R.C. generates the sorts of behaviors and transaction costs feared by foreigners.

China's *domestic* contract law[3] may have reverberations outside the domestic sphere for several reasons. Contracts involving foreigners, though currently regnlated by a distinct piece of legislation, may in future be brought under the aegis of a unified, monolithic contract law,[4] and there is no guarantee that this unified legislation

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[1] See respectively H. Sender, "Party of the First Part: China Tries to Improve Contract Law" *Far Eastern Econ. Rev.* (11 February 1993) 42 at 42; "China Business" (Editorial) *The Wall Street Journal* (18 November 1994) A18; N. Holloway, "Arbitrary Justice: Breach of Contract in China Becomes Test Case" *Far Eastern Econ. Rev.* (20 July 1995) 78 at 78; K. Chen, "The Extent of the Law" (A Report on China) *The Wall Street Journal* (10 December 1993) R5. See also generally R.L. Homan, "World Wire: Beijing Orders U.S. Cafe Closed" *The Wall Street Journal* (22 November 1994) A18; E. Guyot, "Contract Disputes Imperil China's Bid to Raise Foreign Capital, S & P Warns" *The Wall Street Journal* (15 December 1994) A10. Throughout the mid-1990s a continuous stream of such articles has bemoaned contract practices in China.

[2] See respectively Holloway, *ibid.*; "China Business" (Editorial), *ibid.*

[3] China has separate domestic, foreign, and technology contract laws. These are, respectively, (1) Economic Contract Law of the People's Republic of China, 4th Sess., 5th National People's Congress ("N.P.C."), 13 December 1981 (effective 1 July 1982) (translated into English in (1982) 2 China L. Rptr. 61, and reprinted in Chinese in C.P. Li, ed., *Shiyong Falü Shouce (Zhushiben)* [*Practical Handbook of Law (Annotated)*] (Beijing: China Economic Press, 1986) 185) [hereinafter 1982 Contract Law] as am. by 3d Sess., Standing Committee of the 8th N.P.C., 2 September 1993 (bilingual text in S. FitzGerald, ed., *China Laws for Foreign Business*, vol. 1 (*Business Regulation*) (Australia: CCH International, 1993) para. 5-500) [hereinafter 1993 Contract Law]; (2) Foreign Economic Contract Law of the People's Republic of China, 10th Sess., Standing Committee of the 6th N.P.C., 21 March 1985 (bilingual text in FitzGerald, ed., *ibid.*, para. 5-550; other unofficial English translation in 24 I.L.M. 799, Documents, Beijing Rev. (8 July 1985) I) [hereinafter Foreign Contract Law]; (3) Law of the People's Republic of China on Technology Contracts, 21st Sess., Standing Committee of the 6th N.P.C., 23 June 1987 (bilingual text in FitzGerald, ed., *ibid.*, para. 5-577) [hereinafter Technology Contract Law].

[4] Although I was unable to obtain a recent draft of the "proposed unified contract law" (*hetong fa jianyi cao'an*), it has been reported that a copy of it appears in [1995] no. 4 *Minshang Fa Luncong* [*Review of Civil and Commercial Law*]. This draft was submitted to the Judicial System Work Committee of the N.P.C. Standing Committee in January 1995. See H. Liang, "Cong 'Sanzuding Li' zouxiang Tongyi de Hetong Fa" ["Moving from 'Three-legged Legislation' towards a Unified Contract Law"] [1995] no. 3 *Zhongguo Faxue* [*Chinese Legal Science*], reprinted in [1995] no. 9 *Faxue* [*Legal Studies*] (Chinese People's University reprint series topic D41) 109 at 112. In addition to

will privilege doctrines from today's foreign contract law. Moreover, until such a unified law is implemented,[5] it appears that Hong Kong companies may be regulated in their dealings with mainland enterprises by the P.R.C.'s domestic contract law, not its foreign contract law. Neither the *Joint Declaration*[6] nor the Basic Law[7] indicate that mainland—Hong-Kong contracts will be treated as Chinese-foreign contracts. In fact, article 13 of the Basic Law states that the P.R.C. shall retain control over Hong Kong foreign policy, suggesting that Hong Kong will not be a "foreign" entity. More importantly, the National People's Congress Standing Committee may invalidate contracts and other laws which "contravene" its own interpretation of the Basic Law.[8] As well, the legislature of the Hong Kong Special Administrative Region — currently handpicked by Beijing — may amend provisions of Hong Kong's pre-1997 common law, including rules of equity.[9] Until the question is settled which contract law controls under different sorts of circumstances in Hong Kong, understanding the potential commercial-law implications of Hong Kong's handover requires an appreciation of the P.R.C.'s current domestic contract law.

This article begins with a brief rehearsal of the contract system under communist planning. Although far fewer items are covered by the plan than in the past, the *principles* by which planning officials are authorized to interfere in various aspects of contract form, content, formation and dissolution are legacies of the planned economy. Part II discusses three variables that are key to understanding the larger sociopolitical context in which Chinese contract law operates: a lack of separation of powers (and an attendant lack of *stare decisis* and judicial review), the persistent importance of Party committees and "Party groups" (*dang zu*) at many key levels of the

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Liang's article, numerous commentaries by scholars who were active in overseeing and writing the revised law have appeared in Chinese journals (see *e.g.* L.M. Wang, "Tongyi Hetong Fa Zhiding zhong de Ruogan Yinan Wenti Tantao" ["Probing Studies on Several Complicated Problems in the Enactment of a Unified Contract Law"] in [1996] no. 4 *Zhengfa Luntan* [*Tribune of Political Science and Law*] 49 (part 1), [1996] no. 5 *Zhengfa Luntan* 52 (part 2)). One such participant has also published a commentary in English, a translation of a speech given in March 1996 at the Center for Chinese Legal Studies of Columbia University Law School: P. Jiang, "Drafting the Uniform Contract Law in China" (1996) 10 Colum. J. Asian L. 245. To the extent the present article touches on the prospective unified contract law, which it does only sparingly, it draws primarily from these sources.

[5] The date for passage keeps being pushed back, apparently due to the immense political difficulties associated with finding principles acceptable to free marketers and planners, proponents of voluntary exchange and defenders of administrative prerogative, central and local leaders, etc. In the latest development, the unified law was to be enacted at the Fifth Meeting of the N.P.C. in March 1997, but it was not (on planned enactment at the Fifth Meeting, see Jiang, *ibid.* at 245).

[6] *Sino-British Joint Declaration on the Question of Hong Kong*, 19 December 1984, U.K.T.S. 1984 No. 26, reprinted in 23 I.L.M. 1366 [hereinafter *Joint Declaration*].

[7] Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, 3d Sess., 7th N.P.C., 4 April 1990, reprinted in 29 I.L.M. 1519 [hereinafter Basic Law]. Also available at http://www.cityu.edu.hk/Basic Law/b1.htm (17 June 1997).

[8] Basic Law, *ibid.*, arts. 158-60, 17.

[9] *Ibid.*, art. 8.

Chinese economy and bureaucracy, and the fact that the contract law is not unequivocally subordinate to China's *General Principles of Civil Law*.[10]

The substantive analysis which then follows is divided along three elements or stages of the contractual process. These stages are drawn from the textbook definition of "freedom of contract":

> The ability at will, to make or abstain from making, a binding obligation enforced by the sanctions at the law. The right to contract about one's affairs, including the right to make contracts of employment, and to obtain the best terms one can as the result of private bargaining.[11]

First, Part III addresses the question of who may enter a contract. The P.R.C. not only imposes strict legal requirements on who may assume the "juristic person" status necessary to enter into legally protected contracts, but, I argue, direct or indirect state control over vital economic resources continues to render the ability to become a contractor highly dependent on personal and professional connections.

Second, Part IV asks how much negotiation and bargaining is customary or permitted in setting and adjusting contract terms? In essence, voluntary negotiation, a key ingredient in legitimating contracts under Western ideals of freedom of contract, is attenuated by often hidden differences in the legal status of contractors, the still common practice of state interference in pricing decisions, and emphasis on legal doctrines like specific performance.[12] Other factors, such as the lack of a system of offer and acceptance separate from administrative approval, and official emphasis on form contracts, have been much-discussed in the drafting of the unified contract law. They are touched upon accordingly.

Third, Part V surveys the basic characteristics of dispute-resolution forums and contract enforcement. Whether Hong Kong will indeed maintain an independent judiciary is uppermost in the minds of many Hong Kong residents. This section connects legal and institutional arrangements in China's judiciary with many of the maladies that affect the resolution of contract disputes and the enforcement of court decisions in China. Based on this analysis, I conclude that even should China's unified contract law bring China into line with Hong Kong and other foreign legal systems, it is the preservation of Hong Kong's institutional arrangements for mediation, arbitration and adjudication (*e.g.*, which branch of government staffs and finances tri-

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[10] *General Principles of Civil Law of the People's Republic of China*, 4th Sess., 6th N.P.C., 12 April 1986 (effective 1 January 1987) [hereinafter *General Principles of Civil Law*] (bilingual text in FitzGerald, ed., *supra* note 3, para. 19-150; Chinese text also in Li, ed., *supra* note 3, 126. See text below, accompanying notes 67-70.

[11] H.C. Black, *Black's Law Dictionary: Definitions of the Terms and Phrases of American and English Jurisprudence, Ancient and Modern*, 6th ed. (St. Paul, Minn.: West, 1990) at 918 ("liberty of contract").

[12] In Anglo-American law, "specific performance" is the principle that "where money damages would be an inadequate compensation for the breach of an agreement, the contractor or vendor will be compelled to perform specifically what he has agreed to do" (*ibid.* at 1138). This definition does not entirely capture the principle of specific performance as it is practiced in the P.R.C.

bunals, how are personnel appointed and fired) which will most effectively safeguard contracts in Hong Kong.

I. Background: P.R.C. Contract Practice and Law in the Era of Socialist Planning

The post-1949 political earthquake that transformed China's economy culminated by 1956 in a more-or-less fully planned economy. Under planning, ministries set provisional targets based on input and output information from immediately subordinate organs and extrapolation from previous years. These "control" figures would then be sent back to the subordinate organs which rectified them based on figures culled from enterprises and industrial bureaus (in urban areas) or brigades, communes, prefectures, and provinces (in agriculture). This process, sometimes called "planning and counterplanning", is meant to produce a plan which is feasible for individual enterprises yet ensures that the resources of each enterprise are used in accordance with national goals.[13] It has been well-documented how this process can be rife with bargaining, tactical prevarication, implicit threats and peer pressure, and, of course, fiat from above.[14]

Within this system, "contracts" were essentially administrative devices characterized by involuntariness in term-setting and performance. For example, most industrial and wholesale contracts were signed at "goods-ordering conferences" (*dinghuo huiyi*) attended by those who would produce and deliver products under the plan. At these conferences ministries would assign "dancing partners", *i.e.*, a supplier and outlet, for every product. Information shared between the dancing partners and the ministry might influence the terms of the resulting agreement, but the "contract" was not signed on the basis of voluntarism or free negotiation.[15] The function of state-sector contracts was to clarify responsibilities between units, concretize plan targets to workers and managers, and enable responsibility for performance failures to be traced.[16]

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[13] See M. Ellman, "Economic Calculation in Socialist Economies" in J. Eatwell, M. Milgate & P. Newman, eds., *The New Palgrave: Problems of the Planned Economy* (New York: W.W. Norton, 1990) 91 at 91.

[14] On the planned economy in this period, see A. Donnithorne, *China's Economic System* (New York: Praeger, 1967) and D.H. Perkins, *Market Control and Planning in Communist China* (Cambridge, Mass.: Harvard University Press, 1966). On central, ministerial and provincial interaction in formulating plans, see K. Lieberthal & M. Oksenberg, *Policy Making in China: Leaders, Structures, and Processes* (Princeton: Princeton University Press, 1988) at 128-34. On rural teams and brigades setting agricultural production targets, see J.C. Oi, *State and Peasant in Contemporary China: The Political Economy of Village Government* (Berkeley: University of California Press, 1989), especially at 57-62.

[15] See R.M. Pfeffer, *Understanding Business Contracts in China, 1949-1963* (Cambridge, Mass.: Harvard University Press, 1973) at 10-28; L. Cheng & A. Rosett, "Contract with a Chinese Face: Socially Embedded Factors in the Transformation from Hierarchy to Market, 1978-1989" (1991) 5 J. Chinese Law 143 at 169.

[16] See R.M. Pfeffer, "The Institution of Contracts in the Chinese People's Republic (Part I)" (1963) 14 China Q. 153 at 162.

Enforcement was also an administrative matter. Although a much smaller number of commodities than in the Soviet Union was subject to planned allocation,[17] substituted performance — the ability to get one's contract fulfilled elsewhere — was generally unavailable. Since plan inputs and outputs were mutually dependent, failure to perform by one enterprise could produce a chain reaction that might snowball into huge problems for downstream industries. And payment of monetary damages was tainted by the notions that the purpose of exchange was not profit but fulfillment of social need, and that monetary losses would simply accrue to "the whole people". Even had ideology encouraged enterprises to assume financial responsibility for their own performance failures, however, the fact that prices under planning were essentially artificial made it impossible to rationally calculate damages.

In 1950, the new regime had promulgated two laws which decisively shaped dispute resolution and enforcement practices: the "Provisional Methods"[18] and what may be called the "Decision".[19] Their provisions dealt mainly with the newly established cooperatives. They required that the financial committee of higher-level supervisory organs be notified of contract signings and gave responsibility for ensuring proper signing and implementation to the appropriate central ministry. Thus, grain contracts would be supervised by the ministry of agriculture, cooperative consumer goods contracts by the ministry of trade, and so on.[20] In addition to being brought under ministerial control and made to serve the state's financial planning, large categories of contracts were forced to include "guarantor" (*baozhengren*) clauses. The guarantor (a higher-level ministerial office) bore responsibility in case of breach.[21] This codified a core principle of contracts, and economic life generally, under socialist planning — losses do not accrue to the enterprise.

These regulations also established a three-tiered hierarchy for resolving disputes,[22] which reflected the state's preference for "internal" dispute resolution, that is, resolution by a body that is organizationally related to the parties and financially impacted

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[17] Although comparisons are difficult because they used different classification schemes, China's unified allocation system included at its peak in the mid-1960s some 500 goods; the Soviet's included over 5,000 (see C. Wong, "Material Allocation and Decentralization: Impact of the Local Sector on Industrial Reform" in E.J. Perry & C. Wong, eds., *The Political Economy of Reform in Post-Mao China* (Cambridge, Mass.: Council on East Asian Studies, Harvard University, 1985) 253 at 261).

[18] "Jiguan, Guoying Qiye, Hezuoshe Qianding Hetong Qiyue Zanxing Banfa" ["Provisional Methods for Signing Contracts by Organs, State Enterprises, and Collectives"] in Guowuyuan Jingji Fagui Yanjiu Zhongxin Bangongshi [Office of the Economic Laws and Regulations Research Center of the State Council], ed., *Jingji Hetong Fagui Xuanbian* [*Compilation of Laws and Regulations on Economic Contracts*] (Beijing: Worker's Press, 1982) [hereinafter *Compilation of Economic Contract Laws*] 24 [hereinafter Provisional Methods].

[19] "Zhongyang Renmin Zhengfu Maoyibu Guanyu Renzhen Dingli yu Yange Zhixing Hetong de Jueding" ["Decision of the Central People's Government Trade Section Concerning the Conscientious Signing and Strict Implementation of Contracts"] in *Compilation of Economic Contract Laws*, *ibid.*, 27 [hereinafter Decision].

[20] See Provisional Methods, *supra* note 18, art. 9; Decision, *ibid.*, art. 14 and preface. For a discussion of how the state exerted control through such contracts, see Perkins, *supra* note 14.

[21] Provisional Methods, *ibid.*, art. 6; Decision, *ibid.*, art. 3, s. 12.

[22] See Part V below.

by the outcome of the dispute. Post-Mao reforms have challenged this institutional principle but it has not been entirely displaced. Mandating that disputes be resolved by organs with internal relations to the parties creates incentives for mediators to minimize financial damages (since their parent organ would absorb the loss) and to press for specific performance.

Despite experimentation with more economically liberal policies in 1956-57 and 1961-63, vacillations in economic policy before 1978 mask a fundamental continuity in contract use. Three factors account for this: specific regulations, bureaucratic organization, and law. First, regulations have indirectly restricted prices in contracts even during periods of marketization. For example, in the spring of 1955, when cooperatives increased the differential between wholesale and retail prices so that private merchants could earn more profit, they were told what that differential should be. Wholesale prices were determined administratively, not by the market or negotiation. Similarly, although retail outlets could purchase some goods directly from factories under the "selective purchase" system, prices were set by commercial organs, not the factories themselves.[23] Detailed regulations ensured that wholesale prices, and hence contract prices, continued to be determined by the state's perception of social need.

Second, on the bureaucratic level, the historic decentralization of 1957-59 for the most part simply made the province a planning unit like the state writ small. It was felt that decentralization of economic decision-making was required to combat increasingly obvious inefficiencies of the centrally planned economy.[24] Prime among these inefficiencies was "blindly signing contracts" (*mangmu ding hetong*), that is, failure of ministries to investigate market needs and the capabilities of parties before setting the terms of enterprise contracts.[25] But the reform ultimately adopted, as Franz Schurmann has noted, gave more power to provinces (especially local party committees), not production units (central ministries with jurisdiction over specific industries).[26] Specifically, provinces were given control over most light industrial enterprises (except textiles) and non-strategic heavy industry. Even centrally-owned enterprises came under "dual control", meaning management decisions were subject to approval by provincial party committees as well as ministerial organs at the same level. Provinces assumed more control over distribution of materials, pricing and taxes, and they were permitted to include the activities of centrally owned enterprises in their

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[23] See D.J. Solinger, *Chinese Business Under Socialism: The Politics of Domestic Commerce, 1949-1980* (Berkeley: University of California Press, 1984) at 220-21.

[24] Despite elite consensus on the problem, the solution adopted was, of course, a product of political struggle and compromise. For discussion of decentralization, see H. Harding, *Organizing China: The Problem of Bureaucracy 1949-1976* (Stanford: Stanford University Press, 1981) at 107-15 and 175-77; Solinger, *ibid.* at 93-98; C. Riskin, *China's Political Economy: The Quest for Development Since 1949* (Oxford: Oxford University Press, 1987) at 104-107; and R. MacFarquhar, *The Origins of the Cultural Revolution*, vol. 1 (*Contradictions Among the People 1956-1957*) (New York: Columbia University Press, 1974).

[25] See P.B. Potter, *The Economic Contract Law of China: Legitimation and Contract Autonomy in the PRC* (Seattle: University of Washington Press, 1992) at 21-25, esp. nn. 15 and 31.

[26] See F. Schurmann, *Ideology and Organization in Communist China*, 2d ed. (Berkeley: University of California Press, 1968) at 175-76.

own provincial plans. What this reform did *not* do, however, is more important for contracts. Beijing continued to write the price-fixing principles by which localities could alter prices. The center had to approve changes in targets, and the Ministry of Commerce retained the significant powers of "guidance" (*lingdao*), "management" (*guanli*) and "approval" (*pizhun*).[27] Most importantly, the still quite large provincial territorial unit basically performed the same planning functions previously performed by the centre. The logic of planning was unchanged: resource allocation did not occur through freely negotiated exchange. The plan that controlled it was now mostly provincial or regional, not national.

Third, legal developments codified the nature of contracts and the position of contractors. By 1958, a famous civil-law textbook[28] appeared which asserted that civil relations must serve the end of socialism. Some civil relations were to be fostered, others were to be abolished. The property interests of "antagonistic" classes were not granted protection, while state property was inviolable. Law was to be interpreted in terms of state policy; realization of the state economic plan was paramount. Permanent laws were still eschewed lest they become a barrier to socialist transformation.[29] In keeping with the practices of the planned economy, it advised judicial and mediatory bodies to pursue performance rather than compensatory or punitive damages.[30] Clearly, this "civil" law was primarily a bulwark for statist aims. Yet even this dubious foundation for contract freedom was never adopted. In the aftermath of the anti-rightist campaign of 1957 and at the start of the Great Leap Forward in 1958, law was explicitly subordinated to policy.

Similar points could be made about the 1960-62 round of liberalization. At any rate, by March 1962, control over pricing (which had been decentralized to provinces and localities in 1957-58) was recentralized. Later that year the National Price Commission was established. It set prices on all goods except for a handful of agricultural commodities.[31] Although price negotiation in contract formation was thus strictly curtailed, the regime did seek to increase enterprise efficiency through a new approach to contract enforcement. In 1962-63, two regulations evinced unprecedented concern with assigning responsibility for nonfulfillment.[32] No longer were losses

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[27] Solinger, *supra* note 23 at 95-98, emphasizes the powers of the Ministry of Commerce.

[28] Zhongyang Zhengfa Ganbu Xuexiao Minfa Jiaoyanshi [Teaching and Research Section of the Central Political and Legal Cadres' School], ed., *Zhongguo Renmin Gongheguo Minfa Jiben Wenti [Basic Issues of Chinese Civil Law]* (Beijing: Legal Press, 1958).

[29] On the points cited, see *ibid.* at 7-12, 21, 25-30.

[30] See Pfeffer, *supra* note 15 at 29-47.

[31] See J.J. Guo, *Price Reform in China, 1979-86* (New York: St. Martin's Press, 1992) at 19.

[32] "Zhonggong Zhongyang Guowuyuan Guanyu Yange Zhixing Jiben Jianshe Chengxu, Yange Zhixing Jingji Hetong de Tongzhi" ["Circular of the Chinese Communist Party Central Committee and State Council Concerning the Strict Enforcement of Basic Construction Procedures and the Strict Fulfillment of Economic Contracts"] in *Compilation of Economic Contract Laws, supra* note 18, 35 [hereinafter Circular]; and "Guojia Jingji Weiyuanhui Guanyu Gong Kuang Chanpin Dinghuo Hetong Jiben Tiaokuan de Zanxing Guiding" ["Provisional Regulations of the State Economic Committee on the Basic Clauses in Contracts for the Ordering of Factory and Mining Products"] in *Compilation of Economic Contract Laws, ibid.*, 53 [hereinafter Ordering Regulations].

simply to be absorbed by ministries. Liabilities were specified according to the nature of the breach. The supplier bore liability for untimely delivery or deficient quality, while the buyer bore liability for failure to accept delivery or last-minute changes in specifications. In contrast to the emphasis of the 1958 civil law textbook on specific performance or compensation, these regulations permitted penalty clauses, *i.e.*, punitive damages.[33]

Such moves toward contract freedom and responsibility were weakened, however, by provisions regarding dispute resolution. Higher-level management bodies were to mediate, or relevant economic committees were to arbitrate.[34] Pitman Potter has discovered through interviews with Hong Kong émigrés that compensation in the 1960s was almost never total but took the form of a negotiated reduction in payment, echoing traditional norms like "splitting the difference".[35] Still being ultimately responsible, ministerial bodies (who were the mediators) would simply alter production quotas to account for nondelivery. This was more practical than waiting to receive payment or performance. Chronic shortages and quality problems in manufactures often meant buyers faced a "Hobson's choice of accepting the defective goods or waiting for the party in breach to attempt to produce conforming goods." [36] While waiting for performance, no compensation or punitive damages would be levied. In inter-ministerial disputes brought to arbitration before an Economic Committee, perception of social need could determine which ministry would absorb more of the loss.

A draft civil law submitted to the National People's Congress ("N.P.C.") in mid-1964[37] attempted to place the contract principles laid down by the Circular[38] and Ordering Regulations[39] into a larger legal framework. It omitted such principles as equality between parties and voluntary participation in civil-law relations, and defined contract as "an important tool for implementing economic plans, for strengthening economic co-operation, and for facilitating people's lives."[40] Hope of passing even this plan-oriented legislation faded, however, with the onset of the Cultural Revolution in 1966. In 1969, most of the staff of the National Price Commission was sent to the countryside for "re-education through labor", leaving the State Planning Commission of the State Council responsible for price policy. Implementation problems notwithstanding, only fixed prices were permitted for the rest of the Cultural Revolution. No further legal or contract reforms were attempted until after Deng recharted China's economic course in 1978.

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[33] Ordering Regulations, *ibid.*, s. 9, arts. 32-35. See also Potter, *supra* note 25 at 25-26, nn. 45 and 46.

[34] Ordering Regulations, *ibid.*, art. 36.

[35] See Potter, *supra* note 25 at 28.

[36] *Ibid.*

[37] Draft Civil Code of the People's Republic of China (1 July 1964), issued by the General Office of the Standing Committee of the N.P.C. [hereinafter Draft Civil Code].

[38] *Supra* note 32.

[39] *Supra* note 32.

[40] Draft Civil Code, *supra* note 37, art. 68, quoted in J. Chen, *From Administrative Authorisation to Private Law: A Comparative Perspective of the Developing Civil Law in the People's Republic of China* (Dordrecht: Martinus Nijhoff, 1995) at 44.

II. The Nature of the Post-Mao Legal Reforms

The Third Plenary Session of the Eleventh Central Committee of the Chinese Communist Party (December 1978) is generally viewed as the first time China's leadership linked the success of economic reform to the development of a legal system.[41] China's leaders have viewed political reform ("democracy"), economic reform and legal reform as inseparable, but in a very specific manner. Order, control and stability were prime goals in the aftermath of the Cultural Revolution. It was felt that lower-level Party members had been given too much authority to interpret and implement central directives, resulting in near chaos. "Anarchism" and "ultra-individualism", epitomized by Lin Biao and the Gang of Four, were vilified.[42] The leadership sought law that could, on the one hand, protect citizens against official arbitrariness (the main element in the government's definition of "democracy") and, on the other, control the terms of citizens' participation in politics and economics. Only law could guarantee that increased individual participation in the economy and professionalization of enterprise management would occur in an orderly fashion according to principles laid down by Beijing. Law would undergird a renewed "democratic centralism". Lower-level Party cadres would for the first time not just apply law to citizens, but also be subject to it. The inaugural statement of the five-year legal education movement begun in 1985 captures the interrelatedness of democracy, strengthening of central Party control, and economic reform:

> It is necessary to popularize knowledge of the law among the masses of people to enable them to have a good grasp of the law and to cultivate the habit of doing things in accordance with the law. ... When the people are familiar with their rights and obligations, they will enhance their sense of responsibility of being their own masters. ... Only then will they supervise the implementation of the law and the work of state functionaries.[43]

In essence, law was to be a new mechanism for channeling central Party guidance of the economy, bypassing local cadres. One of the central questions for contracts in

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[41] "Communiqué of the Third Plenary Session of the 11th Central Committee of the Communist Party of China" (22 December 1978), trans. in *Beijing Rev.* (29 December 1978) 6.

[42] From 1966 to 1970, Lin Biao, leader of the People's Liberation Army (P.L.A.), implemented Mao's tactic that the army lead the Party in conducting the "movement" politics of the Cultural Revolution. The Gang of Four, led by Mao's wife, Jiang Qing, also led the Cultural Revolution and tried to carry it on after Mao's death, steadfastly opposing any restoration of pre-Cultural Revolution policies aimed at political stability or marketization of the economy. Although frequently at odds, these two "cliques" were tried simultaneously in 1980 and found, ultimately, to be "ultraleftists". When all is said and done, their shared crime seems to have been to disregard norms of intra-elite co-operation, to make grabs for personal power, and to completely nullify party structures, administrative procedures and economic stability — hence, the labels "anarchist" and "ultra-individualist" (see T.W. Wu, *Lin Biao and the Gang of Four: Contra-Confucianism in Historical and Intellectual Perspective* (Carbondale, Ill.: Southern Illinois University Press, 1983), esp. c. 2, 9 and 10; F.C. Teiwes, *Leadership, Legitimacy, and Conflict in China: From a Charismatic Mao to the Politics of Succession* (Armonk, N.Y.: M.E. Sharpe, 1984), s. III).

[43] "Turn Law Over to the People" *Renmin Ribao* [*People's Daily*] (16 June 1985) at 2, quoted in E. Donahoe, "The Promise of Law for the Post-Mao Leadership in China" (1988) 41 Stanf. L. Rev. 171 at 179.

contemporary China, then, is whether the reliability and predictability that in the West derive from embedding contracts in a civil- or private-law framework can be achieved under a regime that views law as a statist tool of policy implementation.

A. The View from the Top: Government Inter-Branch Relations

Deng repeatedly stressed that legal reform was not meant to create an American-style tripartite separation of powers and system of checks and balances.[44] China's legislature, the N.P.C., not only approves legislation, but is empowered by the Constitution to "interpret" laws, a function assumed by the judiciary in many other political systems.[45] Legislative authority over judicial interpretation was clarified in a 1981 N.P.C. resolution which states that the N.P.C. shall "clarify the limits of laws or make supplementary regulations" (*jinyibu mingque jiexian huo zuo buchong guiding*) while the Supreme Court shall interpret "questions of the concrete use of such laws in judicial work" (*shenpan gongzuo zhong juti yingyong ... de wenti*).[46] This seems to mean that the Supreme Court, for example, may say when the circumstances of a case warrant application of a specific law, but, unlike the U.S. Supreme Court, may not elaborate on the case's implications or relationship to other laws, including the Constitution. This resolution terminated any hope of developing a system of judicial review in China. The "court of final appeal" on questions of a law's scope or meaning is clearly the legislative, not judicial, branch. And despite the growing autonomy of the N.P.C. in the reform era, its interpretations of "important economic or administrative laws" are still subject to review and approval by the Party's Politburo or full Central Committee.[47]

The judiciary is also subject to the Party's specific notion of "judicial independence". As Jerome Cohen observed years ago, judicial independence in China means that individual courts are independent from other administrative hierarchies, not from higher courts.[48] A higher court need not wait to hear an appeal to intervene in a case being heard by a lower court. Moreover, the Party is not considered an

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[44] See *e.g.* his speech to military commanders delivered on 9 June 1989 (full text reproduced in "Deng's Talks on Quelling Rebellion in Beijing" *Beijing Rev.* (10-16 July 1989) 18).

[45] The Constitution of the People's Republic of China, 5th Sess., 5th N.P.C., 4 December 1982, as am. by 1st Sess., 8th N.P.C., 29 March 1993 (bilingual text in FitzGerald, ed., *supra* note 3, para. 4-500 at 4-500(67)), art. 67(1) and 67(4) [hereinafter Constitution].

[46] "Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Guanyu Jiaqiang Falü Jieshi Gongzuo de Jueding" ["Resolution of the N.P.C. Standing Committee Providing an Improved Interpretation of the Law"], adopted 10 June 1981, in *Zhonghua Renmin Gongheguo Fagui Huibian* [*Compendia of Laws and Regulations of the PRC*] [hereinafter *PRC Compendia of Laws*] (1981) 27.

[47] See M.S. Tanner's discussion (in "The Erosion of Communist Party Control over Lawmaking in China" (1994) 138 China Q. 381 at 384 and 399) of "Zhonggong Zhongyang guanyu jiaqiang dui lifa gongzuo lingdao de ruogan yijian" ["Several Opinions of the CCP Central Committee on Strengthening Leadership over Legislative Work"], CCP Central Committee Document No. 8 (1991), a "secret" document obtained by Tanner. The Politburo is a core leadership of fifteen to twenty individuals elected by the Central Committee, which has roughly 175 members.

[48] See J.A. Cohen, "The Chinese Communist Party and 'Judicial Independence': 1949-1959" (1969) 82 Harv. L. Rev. 967.

"administrative hierarchy". A practice known as *shuji pi an* ("approval of cases by the [local] Party Secretary") was commonplace in the Mao era and may still be operative in important cases. Even if it isn't, court presidents, who usually belong to local Party committees, have authority to override decisions of particular judges in particular cases. The Supreme Court, for its part, is called not the highest "court" but the highest "judicial organ", exercising "the adjudicatory aspect of the state's unified power."[49] Finally, the judiciary is permitted only a very weak form of *stare decisis*, further undermining independence. Each of these issues will be elaborated momentarily under the topic of dispute resolution in court adjudication.

B. Two Basic Institutional Channels of Party Control

The Party's ubiquitous presence throughout Chinese society is often taken for granted, but two modes by which its power is institutionalized are worth noting. First is the institution of "dual rule" or "parallel rule". Every governmental level is paralleled by a Party committee to which it is directly subordinate. Conflicts between ministries and across localities can be resolved in Party committees both because of their superior authority and because key government officials also belong to them, thus allowing jurisdictional and bureaucratic differences to be hashed out.[50]

Second, government agencies themselves contain "Party groups" (*dang zu*) which, for central ministries, are appointed directly by the Party's personnel office, called the Organization Department.[51] Some observers believe Party groups are even more powerful than Party committees because they play a direct decision-making role (not just supervision) in the policies within each ministry. Whatever the case, Party leaders evidently view them as important sites for establishing control; after briefly being made optional in 1988, they were quickly reinstituted during the post-Tiananmen retrenchment.[52] These basic institutional relations between the judiciary, legislature, Party and all ministerial organs should be kept in mind when reference is made to powers that allow planners and Party officials to intervene in contract formation, dispute resolution, and enforcement.

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[49] S. Finder, "The Supreme People's Court of the People's Republic of China" (1993) 7 J. Chinese L. 145 at 148. See also Constitution, *supra* note 45, art. 123.

[50] The classic treatment of dual rule is Schurmann, *supra* note 26, especially at 188ff. On the importance of Party committees, see Schurmann, *ibid.* at 190-94.

[51] For more on the Organization Department's current role in staffing and monitoring government agencies, see Y. Huang, "Research Note: Administrative Monitoring in China" (1995) 143 China Q. 828.

[52] For a concise discussion of Party committees, Party groups, and the latter's fall and rise, see S. Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993), c. 3.

C. The Ambiguous Relationship of Civil Law to Contract Law

The 1993 Contract Law (like the 1982 law it amended) applies to contracts for purchase and sale, construction, processing,[53] transport of goods, supply of electricity, storage, property leasing, loans, insurance, and "other economic contracts".[54] Any contract involving a foreign entity is governed by the Foreign Contract Law,[55] and any contract for commissioning, cooperatively conducting, or transferring technological research and development is governed by the Technology Contract Law.[56] That said, it should be stressed that the nature of the Contract Law — even whether it falls under the scope of 1987's *General Principles of Civil Law*[57] — is quite cloudy, even to Chinese legal scholars. To appreciate the ambiguities involved, we must begin with the reform context in which the 1982 Contract Law[58] and 1987 *General Principles of Civil Law* came into existence.

1. Economic Reform and the Need for Civil Law

One of the central acts in reforming the planned economy, begun in 1979 on a trial basis and affirmed by the N.P.C. in 1982, was to bifurcate the state economic plan into a traditional "mandatory" (*zhilingxing*) plan and a new "guidance" (*zhidaoxing*) plan. The mandatory plan continued to fix quotas and arrange inputs for vital sectors of the economy while the guidance plan set general allocation goals for the localities that could be implemented and adjusted, with central permission, according to local conditions and the availability of inputs on the market.[59] This created a two-track price system. Goods subject to mandatory purchase and allocation traded at state-set prices; goods sold above quota, or those exempt from mandatory planning, floated at market prices or within bands set by local or central officials.[60] During the decade-and-a-half of reform, certain goods have remained in the mandatory plan, some have remained in the guidance plan, and some have shifted back and forth. Periods when government fought inflation (*e.g.*, 1995) usually saw an increase in the scope of the mandatory plan and controlled prices. The government does not publish a comprehensive list of products subject to price controls, so it is impossible to say

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[53] "Processing contract" (*jiagong chenglan*) is a peculiarly Chinese term that refers to one party contracting to labour on and thereby transform certain materials. It includes "fixed work" (*dingzuo*, in which one party stipulates the labor to be performed on some object, often in reference to transforming fabric into clothing); "renovation" (*xiushan*, often used in reference to housing repair); "repair" (*xiuli*, typically used in reference to repairs on small objects like bicycles and appliances); "printing" (*yinsha*); "advertising" (*guanggao*); and "surveying" (*cehui*) (see R. Liu, ed., *Hetong Falü Cidian* [*Dictionary of Contract Law*] (Beijing: China Auditor's Press, 1993) at 259).

[54] 1993 Contract Law, *supra* note 3, art. 8.

[55] *Supra* note 3.

[56] *Supra* note 3.

[57] *Supra* note 10.

[58] *Supra* note 3.

[59] See Z. Zhao, "Report on the Sixth Five-Year Plan" in *Fifth Session of the Fifth National People's Congress* (Beijing: Foreign Languages Press, 1983) 169.

[60] See B. Naughton, "China's Experience with Guidance Planning" (1990) 14 J. Comp. Econ. 743; Guo, *supra* note 31, c. 6.

with precision which transactions use "free market" pricing. Chinese officials claim that prices are currently set by the market for ninety-five percent of consumer goods and eighty to eighty-five percent of industrial inputs, but it is unclear whether goods subject to price "bands" are included, and officials have recently advocated stricter price "management" and detailed laws clarifying local, central and business responsibilities in pricing decisions. The government has clearly used price ceilings and fiscal subsidies as anti-inflationary devices in the recent past.[61] Despite a definite long-term trend towards price freedom, then, prices floating at market rates at one time may easily be re-controlled, fixed within bands, or otherwise interfered with.

The 1982 Contract Law was enacted precisely to regulate the inevitably expanding number of transactions falling outside the mandatory plan and state-determined prices. The rights and obligations of parties involved in a mandatory planning contract are not governed by the Contract Law but by "relevant laws and administrative regulations."[62] The Contract Law only covers the "market" transactions of China's "market reforms", that is, guidance-plan and no-plan contracts. However, while transactions under the guidance plan (and therefore the Contract Law) are supposed to be characterized by voluntarism, negotiation and equal status between parties, the Contract Law reflects some of the same tentativeness and ambiguity of guidance planning and the dual-track price system. Exactly which transactions are "free" and which subject to some regulation is unclear. Nowhere has the tension between plan and price controls, on the one hand, and contract freedom, on the other, been more apparent than in debates surrounding passage of the *General Principles of Civil Law* in 1987.

First, a terminological clarification. China's government distinguishes civil law from "economic" law. Law governing mandatory-plan contracts is "economic" law. It is administrative in nature. Broadly speaking, the law governing voluntary economic transactions is civil law. The "Economic Contract Law" (the full name of the Contract Law) is, somewhat confusingly, *not* economic law, as it does not regulate contracts that fall under mandatory planning. It is usually considered civil law.[63]

In the lead-up to passage of the *General Principles of Civil Law*, adherents of stronger economic law argued that economic law should govern both hierarchical administrative relations between enterprises and ministries as well as enterprise-to-enterprise relations wherever state or collective resources (*e.g.*, land, materials and finances) are involved. They believed that civil law should be limited to relations involving "consumption" and in which the means of livelihood is under personal ownership. Inter-firm relations under economic law, the argument went, should not be based on equal status, and state intervention should always be possible.[64] On the other side, adherents of the "commodity relations theory" argued that "socialist commodity

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[61] See National Trade Data Bank, U.S. Dept. of Commerce, Market Research Reports No. IMI964011, "China: Price Reform on Hold" (1996).

[62] 1993 Contract Law, *supra* note 3, art. 11.

[63] For more on the civil law/economic law distinction, see M. Kato, "Civil and Economic Law in the People's Republic of China" (1982) 30 Am. J. Comp. L. 429.

[64] For these sorts of views, see "Guanyu Min Fa, Jingji Fa de Xueshu Zuotan" ["Academic Forum on Civil and Economic Law"] [1979] no. 4 *Faxue Yanjiu* [*Studies in Law*] 14.

relations", defined as exchange carried out in the production, allocation, transfer and consumption of material goods, regardless of ownership, should be governed by civil law.[65] Thus, this argument went, enterprise-to-enterprise relations — even between state or collective units — should adhere to principles of voluntariness and equal status; civil-law principles should govern within the sphere of the commodity economy, but state authorities (*i.e.*, the Party) should determine the size of that sphere through policy decisions. These two schools of thought are sometimes called the "small civil law" and "big civil law" schools. The "small civil law" approach would obviously have permitted administrative interference in virtually all significant contract transactions.

In the end, the *General Principles of Civil Law* did not penetrate vertical relations between state administrative organs and enterprises, but did claim exclusive jurisdiction over horizontal (*i.e.*, inter-ministerial), enterprise-to-enterprise commodity relations regardless of the form of enterprise ownership. In theory, all such transactions are between "equal subjects" (*pingdeng zhuti*) whose actions enjoy "equal status" (*diwei pingdeng*).[66] This was considered a victory for the "big civil law" school. Regarding contracts, however, closer examination of both the *General Principles of Civil Law* and the Contract Law reveals it was a partial victory at best.

2. The Relation of the *General Principles of Civil Law* to Contract Law

Chinese law is divided into fundamental (*genben*), basic (*jiben*) and specifically enacted (*danxing*) law. The fundamental law is the Constitution; basic law regulates specific spheres of activity; and "special enactments" (*danxing fagui*) govern in a more specific manner activities discussed in fundamental and basic law. That is, basic law is subordinate to fundamental law and assumes a "leading role" over specific enactments.[67] In actuality, relations of subordination between laws can be unclear and sometimes chaotic. Clearly, the *General Principles of Civil Law* is a basic law on a par with the Administrative Law or the Criminal Law.[68] The Contract Law, however, is sometimes referred to as a "basic law for regulating economic contractual relations", yet is otherwise identified as specially enacted legislation.[69] The Contract Law is generally presumed to be regulated by the *General Principles of Civil Law*, but

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[65] The commodity relations theory was advocated by perhaps China's foremost expert on civil law, Tong Rou, who died in 1991. For a discussion in English of his thought, see W.C. Jones, ed., *Basic Principles of Civil Law in China* (Armonk, N.Y.: M.E. Sharpe, 1989), a translation of Tong's *Minfa Yuanli* [*General Principles of Civil Law*].

[66] *General Principles of Civil Law*, *supra* note 10, arts. 2 and 3.

[67] R. Tong, trans. J.K. Ocko, "The *General Principles of Civil Law of the PRC*: Its Birth, Characteristics, and Role" (1989) 52:2 Law & Contemp. Probs. 151.

[68] See Q. Liu, ed., *Min Fa Jiaocheng* [*A Course in Civil Law*] (Beijing: China People's Public Security University Press, 1993) at 6.

[69] On the Contract Law as "basic" contract law, see Z. Liu, ed., *Xin Jingji Hetong Fa* [*The New Economic Contract Law*] (Beijing: China Auditor's Press, 1994) at 1. On the Contract Law as specially enacted legislation, see Liu, *A Course in Civil Law*, *ibid.* at 7.

there has been some debate on that subject.[70] Even the Contract Law's dominant status in the contract realm is uncertain. A high-level Commerce Bureau official recently argued that its paramount status over contracts is being undermined by a proliferation of contract laws that govern specific kinds of transactions; that is, it is sometimes treated as just one of many contract-related specific enactments.[71]

Such confusion is exacerbated by the fact that the *General Principles of Civil Law* was enacted five years *after* the 1982 Contract Law. This meant it could not serve as a foundation for the Contract Law (as civil codes usually ground specific legislation), but is an attempt to harmonize and codify previously unarticulated general principles that underlie a broad spectrum of statutes and regulations (of which the Contract Law is one) which predate it. The *General Principles of Civil Law* also lacks the "Special Parts" which in most civil-law systems illustrate how principles apply to specific situations. Specific topics are instead addressed in specially enacted laws like the Contract Law. The Chinese government views this arrangement as "an innovation in the history of civil legislation" designed to facilitate state control and flexibility during the "unique historical circumstances" generated by reform.[72] Unfortunately, it also creates confusion as to what law governs in particular situations and what general principles apply.

A cursory comparison of the conceptual underpinnings of the *General Principles of Civil Law* and the Contract Law reveals obvious tensions. The *General Principles of Civil Law* regulates property and personal relations between equal subjects based on German civil-law concepts such as "civil legal act", "juristic person", and "agency". It appears to conceive of a highly individualistic world quite compatible with freedom of contract. For example, it defines a contract as "an agreement between parties to establish, alter, or terminate a civil law relationship" and allows the contract or agreement between the parties to establish such crucial terms as quality, duration, place and price.[73] Nonetheless, the Chinese state does not go so far as to equate civil law with "private" law, as is usually done in the West.

> Our country's civil law is public law, not private law. ... "Private law" assumes that in handling matters between private individuals the state cannot interfere unless one party brings a lawsuit. ... Economic activity in our country is basically made up of economic transactions between social organizations made up of juristic persons and such organizations and citizens. ... State procuratorial

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[70] See *e.g.* J. Liu, "Dui Xiuding 'Jingji Hetong Fa' Ruogan Jiben Wenti de Tantao" ["An Inquiry into Several Basic Issues Concerning Revising the Economic Contract Law"] [1992] no. 6 *Faxue Yanjiu* [*Studies in Law*] 48 [hereinafter "Inquiry"].

[71] In addition to the current Foreign Contract Law and Technology Contract Law, recently proposed legislation includes a Commercial Contract Law (*Shangye Hetong Fa*), Insurance Contract Law (*Baoxian Hetong Fa*) and Credit Contract Law (*Xindai Hetong Fa*) (see "Inquiry", *ibid.*).

[72] Tong, *supra* note 67 at 158.

[73] *General Principles of Civil Law*, *supra* note 10, arts. 85 and 88.

> organs (*guojia jiancha jiguan*) not only supervise criminal matters, but also supervise (*jiandu*) certain economic activities.[74]

Perhaps more in the public-law spirit, the Contract Law by contrast explicitly limits who can enter into contracts and under what circumstances. Price terms may only be negotiated if state policy and the plan allow. All contracts must be in writing. The Contract Law, with a few exceptions, only governs contracts between juristic persons. And Commerce Bureau and government offices at the county level or above possess vague, potentially intrusive authority to "supervise" (*jiandu*) contracts according to administrative regulations.[75] Although the Contract Law is generally called a civil-law enactment, its spirit is so administrative that scholars actually talk about the need to co-opt contract law *into* civil law. One scholar suggested first drafting a unified economic-contract code (containing general provisions pertaining to all economic contracts, including foreign and technology contracts), to be followed by a civil-contract code, which would pave the way towards eventual absorption of the economic- and civil-contract codes into whatever complete Civil Code is ultimately adopted.[76]

Contract legislation whose scope is unclear, and that may or may not be subordinate to what is at any rate a public-law-spirited civil law, is bound to be a less than hearty guarantor of contract freedom. With this background in mind, let us now examine the issues of who may enter a contract, the role of bargaining and equal status, and dispute resolution and enforcement processes.

III. Who May Enter a Contract? Legal Personality and Juristic Personhood

In civil-law countries, "legal person" is usually defined as a "right and duty-bearing unit" and includes juristic persons (legally constituted entities like corporations) and natural persons (individuals). In most civil-law countries, juristic and natural persons — in their capacity as legal persons — enjoy roughly the same right to enter into legally protected contracts. In China, that right is reserved for juristic persons.

This point is often obscured in writings on Chinese law because the Chinese use a single term, *faren* (literally "law-person"), that may be translated as either juristic or legal person. But *faren* does not include natural persons and is therefore comparable to "juristic person". The tradition of limiting participation in contracts to juristic persons dates back to the 1950 Provisional Methods, which stipulated that a contract cannot be made with an individual, but must be "executed by a juristic person."[77] The 1982 Contract Law reiterated this restriction (art. 2) but added that individual household enterprises and members of agricultural communes, though not juristic persons, could form contracts between themselves and juristic persons "with reference to"

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[74] Liu, *A Course in Civil Law*, *supra* note 68 at 6. The word *jiandu* implies a before-the-fact control even more comprehensive than the after-the-fact investigation and rectification implied by *jiancha*.

[75] Provisions cited are from the 1993 Contract Law, *supra* note 3, arts. 17(3), 3, 2 and 44, respectively.

[76] See "Inquiry", *supra* note 70.

[77] Provisional Methods, *supra* note 18, art. 5.

(*canzhao*) the Contract Law (art. 54). Some scholars argued that article 54 in fact permitted natural persons to sign economic contracts, and thus contradicted article 2.[78] This interpretation may exaggerate the 1982 law's liberality. The regime probably never saw itself granting natural persons such rights. Why? First, contracts formed "with reference to" the Contract Law may not enjoy protection *under* it. Second, household enterprises and commune officials are not natural persons: "they are not the same as ordinary individual citizens."[79] Later developments confirm that the state never intended to relax the juristic-person requirement. Although household enterprises and "agricultural contract management households" were eventually incorporated into the 1993 Contract Law (art. 2), an authoritative 1994 Commerce Bureau contract reference book still states that "any unit that does not possess juristic person 'qualifications' (*zige*) cannot sign an economic contract."[80] "Citizens" (*gongmin*), it notes, enjoy some civil-law rights (such as the right to work and to inherit personal property), but do not, in their capacity as citizens, enjoy rights reserved to juristic persons, including the right to engage in foreign trade, banking and insurance business.[81] In short, if an entity is not a properly approved and registered juristic person, it runs the risk that its contracts might not be protected by the provisions of the Contract Law.

How is juristic personhood administered by law? Requirements from the 1987 *General Principles of Civil Law* are clear only as far as they go: A juristic person must be established in accordance with law, possess property or funds, and possess a name and premises. But a juristic person must also be "able to assume civil obligations independently."[82] Who decides when an applicant is qualified to do so? The *General Principles of Civil Law* goes on to state that civil obligations may be assumed by state-owned, collective and various foreign enterprises that meet state capital requirements and are properly registered.[83] Again, qualifications for approval to register are nowhere spelled out. In effect, there is a tautology: the right to *be* a juristic person — a *prerequisite* for assuming civil obligations — is restricted to those who *may* assume civil obligations. This tautology is resolved by neither the 1982 and 1993 Contract Laws, which do not address business registration, nor later regulations governing the establishment and registration of various sorts of enterprises. State Council regulations (1988) govern the process by which private enterprises register with the Industrial-Commercial Administrative Management Bureau ("Commerce Bureau"). They require that applicants either be created or approved by a government

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[78] For example, Cheng & Rosett argue that article 54 mandates the actors it mentions to "follow" the Contract Law (Cheng & Rosett, *supra* note 15 at 206). Potter suggests that the 1982 law meant to extend contracting rights to "units (or individuals) who had the requisite financial capacity to perform their obligations ..." (*supra* note 25 at 32).

[79] " ... *tamen ye butong yu yiban de gongmin geren*" (Li, ed., *supra* note 3 at 222 (annotation to art. 54, 1982 Contract Law)).

[80] Z. Wang *et al.*, *Zhongguo Hetong Daquan (Xiudingban)* [*Handbook of Chinese Contracts (Revised Edition)*] (Beijing: Economic Management Press, 1994) at 1313.

[81] *Ibid.* at 24-26.

[82] *General Principles of Civil Law*, *supra* note 10, arts. 36-40.

[83] *Ibid.*, art. 41.

or ministerial body, or be pre-approved by the Commerce Bureau itself.[84] The (pre-)approval procedures which governments or Commerce Bureau offices must follow are nowhere defined. Even the eagerly anticipated Company Law of 1994 (governing privately-held and share corporations) did not clear things up: accompanying registration regulations also stipulate that companies must be pre-approved by a governmental body or the Commerce Bureau itself.[85] In other words, a would-be contractor does not possess a "right" to become a juristic person provided he or she meets some objective standard; he or she is granted permission to become a contractor based upon the good will or internal policy directives of local governments and Commerce Bureau offices.

The history of the concept of juristic person in China suggests that the state probably keeps approval criteria intentionally vague. Briefly introduced under the Kuomintang ("KMT") civil code of 1930, the concept of juristic person was initially rejected in the P.R.C. because it was seen as a pillar of the legal superstructures attending "commodity (*i.e.*, capitalist exchange) economies".[86] The landmark 1958 legal textbook simply classified juristic persons administratively according to forms of ownership (*e.g.*, state, collective, etc.).[87] The 1964 draft civil law did not mention them at all. Academic discussion of legal personality then reappeared in 1980 in the context of policy debate over granting state enterprises greater operational autonomy.[88] Some argued that greater enterprise autonomy required separating enterprise liabilities from state liabilities and that the institution of legal personality would perform just that function. When "juristic person" was finally reintroduced, beginning with the 1982 Contract Law, it was intended to implement this change in economic administration, not to recognize associations or groups as analogs to rights-bearing individuals, as in the Western tradition.[89] This is, in the main, why individuals and enterprises without authority over state property were excluded from the definition of juristic person. The purposes of "enterprise juristic persons" are to recognize enterprises as relatively independent, to protect their business activities, to allow them to use the property they own or manage, to separate the enterprises' property from the state's for the purpose

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[84] "Zhonghua Renmin Gongheguo Qiye Fa Ren Dengji Guanli Tiaoli" ["Regulations of the P.R.C. for Managing the Registration of Enterprise Juristic Persons"], effective 3 June 1988, in *PRC Compendia of Laws*, *supra* note 46 (1988) 900, arts. 4, 5, 7, 14 and 15.

[85] "Zhonghua Renmin Gongheguo Gongsi Dengji Guanli Tiaoli" ["Administrative Rules of the P.R.C. Governing the Registration of Companies"], State Council of the P.R.C., 24 June 1994, arts. 4 and 7 (in FitzGerald, ed., *supra* note 3, para. 13-568). The Company Law is "Zhonghua Renmin Gongheguo Gongsi Fa" ["Company Law of the P.R.C."], 5th Meeting (Standing Committee), 8th N.P.C., December 1993 (effective 1 July 1994) in (1994) 9:2 China L. & Prac. 7.

[86] H.F. Cui, "Lun Faren Zhidu" ["On the System of Legal Personality"] [1984] no. 6 *Zhengzhi yu Falü* [*Politics and Law*] 51 at 52.

[87] See *Basic Issues of Chinese Civil Law*, *supra* note 28.

[88] See *e.g.* S.Y. Gao, "Faren Zhidu Dui Woguo Shixing Sihua de Xianshi Yiyi" ["The Practical Significance of the Institution of Legal Personality to the Realization of China's Four Modernizations"] [1980] no. 4 *Faxue Yanjiu* [*Studies in Law*] 15.

[89] On how contending theories of legal personality in the West have revolved around the question of what it means to say a group is a "person", see R. Pound, *Jurisprudence*, vol. 4 (St. Paul, Minn.: West, 1959) at 220-61.

of liability, and to assure foreigners that they are dealing with independent companies.[90] As the civil-law scholar Tong Rou put it, legal personality "is an important legal tool of a ruling class for maintaining and developing the economy."[91] But,

> treating legal personality as a legal tool and as being a product of the will of the ruling class, Chinese "theory" effectively rejects the real essence of this private law institution, that is, treating individuals and organizations as well as the state as equal and abstract subjects of rights.[92]

What are the basic goals the state has pursued through control over who enters contracts? Essentially, non-state-owned businesses — household, private and collective — have been promoted to reduce unemployment and augment production and services in the tertiary sector, a sector ignored or suppressed under the planned economy. Opportunities are rationed accordingly. Household enterprises, for instance, may only be established by unemployed youth, laid off or "idle" (*xiansan*) personnel, or skilled retirees, and they are restricted to trades like retail, transportation, personal services (*e.g.*, haircutting), and small-scale repair.[93] A number of policies that usually function in the "background" also support the rationing of these opportunities. The Constitution still upholds socialism as the "fundamental system" (*jiben zhidu*) and the state-managed economy as its "leading force" (*zhudao liliang*). And the reforms are guided by Deng's famous Four Cardinal Principles: to uphold the socialist road, the people's democratic dictatorship, leadership by the Party, and Marxism-Leninism/Mao Zedong Thought.[94] In general, the business approval process is meant to ensure that enterprises "satisfy the necessities of the state and the society" to promote production, convenience, and efficiency.[95]

The state has taken great care to ensure that it does not lose control over the decision to permit or deny someone the right to engage in legally protected economic exchange. Behind a veneer of civil-law language lie carefully constructed "veto points". These make it impossible for would-be businesspersons who are denied juristic personhood to assert against the state a "right" to contract; *i.e.*, they cannot accuse the state of violating the law or their rights. The formal institutional barriers to engaging

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[90] Z. Zhao, trans. W. Zhao, "Enterprise Legal Persons: Their Important Status in Chinese Civil Law" (1989) 52:3 Law & Contemp. Probs. 1 at 3-6.

[91] R. Tong *et al.*, *Zhongguo Minfa* [*Chinese Civil Law*] (Beijing: Legal Press, 1990) at 94-95.

[92] Chen, *supra* note 40 at 107.

[93] "Guowuyuan Guanyu Chengzhen Feinongye Geti Jingji Ruogan Zhengcexing Guiding" ["Several State Council Policy Regulations Concerning City and Township Non-Agricultural Household Economies"], issued July 1981, in *PRC Compendia of Laws*, *supra* note 46 (1981) at 283; and "Guowuyuan 'Guanyu Chengzhen Feinongye Geti Jingji Ruogan Zhengcexing Guiding' de Buchong Guiding" ["State Council Supplementary Regulations to 'Several Policy Regulations Concerning City and Township Non-agricultural Household Economies'"], issued April 1983, in *PRC Compendia of Laws*, *supra* note 46 (1983) 511.

[94] See X.P. Deng, "Uphold the Four Cardinal Principles" (30 March 1979) in *Selected Works of Deng Xiaoping, 1975-1982* (Beijing: Foreign Languages Press, 1984) 166 at 172.

[95] Zhao, *supra* note 90 at 4.

in productive economic activity are very real and potentially high; how high depends largely on how local officials use their considerable discretionary power.[96]

IV. Equal Status and Negotiation: Contract Formation and Performance

Having been passed before the 1987 *General Principles of Civil Law*, the 1982 Contract Law is, in theory, more influenced by "economic" law than the 1993 Contract Law. Indeed, the 1982 Contract Law was instituted when the state plan still regulated most economic activity. Its *raison d'être* includes "safeguarding the socialist economic order, improving economic 'effectiveness' (*xiaoli*), and ensuring implementation of the state plan."[97] It states that contracts must accord with the demands of the state plan and declares void any contracts that violate the state plan or "state interests or society's public interests" (*guojia liyi huo shehui gonggong liyi*).[98] Any disputes over contracts involving the mandatory plan are to be handled administratively by the "higher-level planning bodies responsible" (*shangji jihua zhuguan jiguan*). And contracts under guidance planning should be signed "with reference to" (*canzhao*) plan targets while conforming with the "real situation" (*shiji qingkuang*) of the enterprises involved.[99]

On the surface, the changes which resulted in the 1993 Contract Law free contracts from the strictures of the plan. The 1993 law's *raison d'être* replaces "implement the state plan" with "safeguard healthy development of the socialist market economy."[100] Contracts no longer must accord with the requirements of state policy and planning, but only with laws and administrative regulations.[101] These changes imply less direct state intrusion into the economy. Deeper analysis seems to indicate, however, that the state has not really relinquished much discretion to interfere in contracts. Broadening the types of entities that fall under the Contract Law's scope certainly did not dilute the principle of state control over who enters contracts. In addition, "administrative regulations" may be issued by planning authorities and may be just as intrusive and oriented to the plan as policy or the plan itself. Moreover, the prohibition against contracts that violate state or public interests remains. This in itself grants Chinese courts much broader grounds for nullifying contracts than are avail-

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[96] For more on the practical realities of obtaining juristic-person status (*i.e.*, getting one's business approved and registered), see S. Young, *Private Business and Economic Reform in China* (Armonk, N.Y.: M.E. Sharpe, 1995); W. Kraus, trans. E. Holz, *Private Business in China: Revival between Ideology and Pragmatism* (Honolulu: University of Hawaii Press, 1991); D. Rubenstein, *Transaction Costs and Market Culture under China's Contract Law Reform* (Ph. D. dissertation, University of Minnesota, 1996).

[97] 1982 Contract Law, *supra* note 3, art. 1.

[98] *Ibid.*, arts. 4 and 7. A contract may also be found only partly invalid, in which case the unaffected parts remain valid.

[99] *Ibid.*, art. 11.

[100] 1993 Contract Law, *supra* note 3, art. 1.

[101] Compare 1982 Contract Law, *supra* note 3, art. 4 with 1993 Contract Law, *ibid.*, art. 4.

able to U.S. courts, for example.[102] In fact, many provisions of the 1993 Contract Law continue to leave the state "principled ambiguity" to do as it pleases.

"Freedom of contract" implies, among other things, that neither party has "more rights" than the other and that the contract terms the parties freely negotiate and agree to should govern their relationship. In China, the state, through its economic plans and state-owned enterprises, endows certain "civil law" actors with special powers that may conflict with the principle of equal status. Contract principles that potentially impinge on equal status and negotiation basically fall into two categories: contract formation and contract performance. In the analysis that follows, special attention is paid to whether principles in each category tend to guarantee, or leave room for interference with, equal status and free negotiation.

A. Contract Formation

Article 5 is the main provision of the 1993 Contract Law that appears aimed at increasing parties' freedom to form a contract according to their will. The 1982 law stated, in the same article, that contracts "must adhere to the principles of equality and mutual benefit, agreement through consultation, and compensation for equal value." The 1993 law replaces "must adhere to" (*bixu guanche*) with the less strict "should abide by" (*yingdang zunxu*) and omits "compensation for equal value". Courts had used the latter phrase to overturn freely negotiated price terms that they deemed unfair.[103] Some scholars thus touted the change in article 5 as heralding greater freedom of contract.[104]

But, in the context of Chinese jurisprudence, the meaning of this change is not so clear. The "principle of compensation for equal value" (*dengjia youchang de yuanze*) did not originally mean equal, fair or just division of the benefits of an exchange, but rather that parties possessed a *right* to compensation, a right not recognized by the state under economic law, administrative law, or plan-oriented policy.[105] In this light,

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[102] In the landmark case of *Home Building & Loan Association* v. *Blaisdell*, 290 U.S. 398, 54 S. Ct. 231 (1934) [hereinafter cited to U.S.], the U.S. Supreme Court reinterpreted the "contract clause" of the U.S. Constitution (art. I, § 10), which states that "No State shall ... pass any ... Law impairing the Obligation of Contracts." However, the judgment, upholding moratoriums on farm foreclosures during the Depression, sanctioned state laws that achieve a "rational compromise between individual rights and public welfare" (*ibid.* at 442) in responding to economic "crises" that threaten the very "economic structure upon which the good of all depends" (*ibid.*). This ruling may in practice allow governments broad discretion to interfere with contracts, but the *principle* on which it rests — ameliorating economic *crises* — is much more restrictive than preventing "harm" to "state or public interests".

[103] For examples, see P.B. Potter, "Riding the Tiger: Legitimacy and Legal Culture in Post-Mao China" (1994) 138 China Q. 325 at 343-44, nn. 91-93.

[104] Pitman Potter, referring to article 5 in notes to his translation of the 1993 Contract Law revision, wrote, "parties have been granted more autonomy in concluding their bargains" ("Economic Contract Law Revision" (1993) 9 China L. & Prac. 40 at 48).

[105] This is made quite clear in S. Qi, "Jingji Fa shi yi ge Zhongyao de Duli de Falü Bumen" ["Economic Law is an Important, Independent Branch of Law"] in "Academic Forum on Civil and Economic Law", *supra* note 64 at 15.

that it has been omitted from the 1993 Contract Law may mean that the right to compensation has been attenuated. If so, one of the characteristics that distinguished the Contract Law from economic law would be diluted, resulting in a weakening of principles of contract freedom. It is too early to tell what was intended by this change and what its result will be.

Whatever standards of equal value are brought to bear on contractors, however, it is the very fact that China has until now used administrative approval instead of a system of "offer and acceptance" which has continued to lend Chinese contracts a highly administrative flavour. That is, generally speaking, a contract becomes binding only when it is duly authorized, typically by the local office of the Commerce Bureau or ministry of justice.[106] Although a systematic concept of offer and acceptance is on the agenda of the unified contract law,[107] it is currently nonexistent in China.

B. Contract Performance and Nonperformance

The changes in the 1993 Contract Law which most influence equal status and negotiation involve contract performance. Under mandatory planning, parties were subject to "specific performance"; that is, contracts were administrative orders, so administrators could order a party to perform specifically what he had "agreed" to do, no matter how impractical or costly.[108] Anglo-American law also recognizes the doctrine of specific performance, but conceives of it in terms of remedying loss, not in terms of fulfilling administrative orders.[109] That is, the need for performance is evaluated in terms of the cost or benefit to the parties themselves. Parties are usually free to break an agreement so long as they are willing to pay the price. Chinese law still tends to view specific performance in terms of administration, not freedom, of contract.

One of the most common methods for determining the cost of terminating an agreement is "liquidated damages", defined as "the sum which party to contract agrees to pay if he breaks some promise ..."[110] It is a pre-estimate of probable loss and is often paid up front (like a deposit). It thus differs from compensatory damages, which are determined after the breach by a court or other third party. China's reform-era legislation has emphasized something that appears very similar to liquidated damages, called "breach fees" (*weiyue jin*), but with a distinctly administrative flavor.

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[106] Whether or not Commerce Bureau or ministry of justice approval is required has in fact been an area of some disagreement among legal scholars. Though I would argue such approval is almost always optional, courts certainly may be more likely to void a contract that is without it, and approval may be required from other administrative organs via rules that remain unpublished. For a more extended discussion, see the author's *Transaction Costs and Market Culture under China's Contract Law Reform*, *supra* note 96 at 184-88.

[107] See Jiang, *supra* note 4 at 249; Liang, *supra* note 4 at 111.

[108] On the importance of "specific performance" under planning, see J.V. Feinerman, "Legal Institution, Administrative Device, or Foreign Import: The Roles of Contract in the People's Republic of China" in P.B. Potter, ed., *Domestic Law Reforms in Post-Mao China* (Armonk, N.Y.: M.E. Sharpe, 1994) 225.

[109] See *supra* note 12.

[110] *Black's Law Dictionary*, *supra* note 11 at 391.

An American court, when addressing a breach of a contract that contains a liquidated-damages clause, will ask: Was the intention of the parties that the contract actually be performed (in which case specific performance may be invoked simultaneously with liquidated damages), or was it that the liquidated-damages clause constitute "a price fixed for the exercise of an option to terminate" (in which case payment of liquidated damages would suffice)?[111]

Chinese law does not make this distinction. The 1982 and 1993 Contract Laws state that even if "breach fees" are paid, the breachor "should" still carry out the contract "if the other party so requests."[112] The ambiguous term "should" (*yingdang*) has allowed proponents of civil law (who interpret it as an admonition) and economic law (who interpret it as an imperative) to press their own interpretations. For instance, one advocate of economic law argues that, under this clause, courts should have the option of ordering specific performance to ensure that fulfilling the state economic plan remains the economy's top priority; under socialism, the *raison d'être* of economic exchange should be to satisfy social demand, not simply create profit.[113] Courts that favor this interpretation might invalidate a freely agreed-upon price for termination if they determine performance is in the public good. And, as has been oft criticized by legal scholars (but will probably change under the unified contract law), the 1982 and 1993 Contract Laws depart from prevalent international practice in *requiring* parties to include "breach fee" clauses and, in many cases, stipulating the amount.[114] Breach fees have been viewed as administrative punishment, not just compensation.[115] Bolstering court discretion to order strict performance is a provision which prohibits either party from changing a contract "without authorization" (*shanzi*).[116]

It might be that judges not only *may* enforce specific performance but are often compelled to do so by governmental or ministerial officials. There have been some calls to introduce a Western doctrine — *rebus sic stantibus* or fundamental change of circumstances — that would expand the grounds available to contractors (and judges) for altering contracts.[117] *Rebus sic stantibus* is "a tacit condition, said to attach to all treaties, that they shall cease to be obligatory so soon as the state of facts and condi-

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[111] For precedents as early as the 1920s that establish this distinction, see J.D. Calamari & J.M. Perillo, *The Law of Contracts* (St. Paul, Minn.: West, 1970) §§ 14-34.

[112] 1993 Contract Law, *supra* note 3, art. 31. The actual wording is "[If] the other party requests continued performance of the contract, [the breachor] should continue to carry it out" (*duifang yaoqiu jixu lüxing hetong de, ying jixu lüxing*).

[113] W. Wang, "Lun Hetong de Qiangzhi Shiji Lüxing" ["On the Coercive Enforcement of Contract"] [1984] no. 3 *Faxue Yanjiu* [*Studies in Law*] 46.

[114] For criticisms of this system, see Jiang, *supra* note 4 at 250.

[115] L. Wang *et al.*, "Wanshan Woguo Weiyue Zeren Zhidu Shi Lun" ["Ten Views on Perfecting China's System of Responsibility for Breach of Contract"] [1995] no. 4 *Zhongguo Shehui Kexue* [*Chinese Social Science*] 4, reprinted in [1995] no. 12 *Faxue* [*Legal Studies*] (Chinese People's University reprint series topic D41) 85 at 93-94.

[116] 1993 Contract Law, *supra* note 3, art. 6.

[117] Z. Yang, "Shilun Woguo Minfa Queli 'Qingshi Biangeng Yuanze' de Biyaoxing" ["On the Necessity of Establishing 'The Principle of Changed Circumstances' in China's Civil Law"] [1990] no. 5 *Zhongguo Faxue* [*Chinese Legal Science*] 53.

tions upon which they were founded has substantially changed."[118] It would allow courts to rescind or modify contracts in light of changes in background conditions that are external to the parties, fall under *force majeure* (discussed next), and result in manifest inequity. The perceived need for such a doctrine may suggest that contractors and judges are groping for a doctrinal counterweight to the administratively-oriented Chinese version of specific performance. To my knowledge there have been no plans to introduce *rebus sic stantibus* into China's contract law.

Vestiges of the planned economy's performance imperative touch even rather arcane doctrines like "anticipatory repudiation", when one party suspends performance of or rescinds a contract because he has unequivocal evidence that the other party "will not render its performance under the contract when that time [time fixed for performance in the contract] arrives ..."[119] Under articles 2-609 and 2-610 of the U.S. Uniform Commercial Code ("U.C.C."), suspension or rescission is justified if one merely has "reasonable grounds" for believing one's partner will not (*e.g.*, through verbal statements) or cannot (*e.g.*, because of financial or production difficulties) perform.[120] Under a similar doctrine from the German BGB, *exceptio adimpleti non contratus*, one may suspend performance if there is a "significant deterioration in the financial position of the other party" which endangers one's claim for counterperformance.[121]

In China, one may suspend performance due to another's anticipatory repudiation only under the Foreign Contract Law, not the 1993 Contract Law, and that provision[122] seems to have been added, reluctantly, only because of international standards.[123] Even under the Foreign Contract Law, stricter conditions are put on its exercise than in either the U.C.C. or BGB. First, the party exercising its right to suspend performance must have "conclusive evidence" (*queqie zhengju*) that the other party cannot perform; "reasonable grounds" will not do. Second, one may only suspend, not rescind, performance.[124] Third, one is liable for breach if he later cannot prove that the other party could not perform. In addition, the Chinese law does not encompass what one analyst has called "clear repudiation" (*mingshi huiyue*), or explicit statements by

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[118] *Black's Law Dictionary*, *supra* note 11 at 1267.

[119] *Ibid.* at 93 ("anticipatory breach of contract"). The phrase "anticipatory repudiation" refers to the act of the party who is unable or unwilling to perform (his "repudiation", or breach, is "anticipatory", or prospective, not actual). Somewhat confusingly, using another's anticipatory repudiation as a justification for your own breach is also often called "anticipatory repudiation".

[120] See also Y. Zhao, "A Comparative Study of the Uniform Commercial Code and the Foreign Economic Contract Law of the People's Republic of China" (1988) 6 Int'l Tax & Bus. Law. 26 at 46 n. 133.

[121] *The German Civil Code: Revised Edition (as amended to January 1, 1992)*, trans. S.L. Goren (Littleton, Colo.: Rothman, 1994), art. 321 [hereinafter BGB].

[122] Foreign Contract Law, *supra* note 3, art. 17.

[123] For details, see B. Gong, "The Future Direction of the PRC Economic Contract Law" (Shanghai: Law School of Fudan University, 1995) at 19-20 [unpublished].

[124] In this, art. 17 of the Foreign Contract Law, *supra* note 3 approaches art. 321 of the BGB, *supra* note 120.

one's partner that he is unwilling to or will not perform. It only covers "tacit repudiation" (*moshi huiyue*), that is, an inability to perform.[125]

Obviously, the Foreign Contract Law's stance on suspending performance in response to anticipatory repudiation makes it difficult for creditors to suspend or rescind deals even when they may have good reason to believe their partner may default. Under domestic-contract law, no form of the principle exists. As part of China's transition from a planned economy to a socialist market economy, however, the performance imperative implicit in China's approach to this doctrine is giving way to a recognition that a strong form of the anticipatory-repudiation doctrine would be good for creditors; it is one of the doctrines, in its Anglo-American form, that is being pushed most heavily by scholars involved in drafting the unified contract law.[126] Nonetheless, there are apparently no plans to relax the requirement of "conclusive evidence" and the attendant liability for breach if one fails to produce it, or to explicitly recognize "clear repudiation".[127] In other words, until the unified contract law is passed, and depending upon how it addresses the issue of anticipatory repudiation, the state continues to emphasize performance. In general, contractors lack the right to decide for themselves, based on the relative costs (and risks) of performing, whether to perform.

The power to order specific performance (at the request of one party) is clearly an access point for state interference in negotiation — a negotiated price for termination may be overridden. Court authority to mandate performance is mirrored by considerable discretion in deciding what counts as a valid excuse for *non*performance. Such discretion results from ambiguity in a change to the 1982 Contract Law that, at first glance, seems to reduce the possibility of outside interference in freely negotiated contract terms. Under the 1982 Contract Law, one permissible excuse for nonperformance was a change in the state plan that made it impossible or excessively costly to carry out a contract (*e.g.*, either expected materials were not allocated or prices changed).[128] This clearly subordinated contracts to planning and was rescinded in the 1993 Contract Law. Now, the only permissible grounds for modifying or rescinding a contract are failure of the other party to perform and *force majeure* (*buke kangli*).[129] But due to ambiguities in the doctrine of *force majeure* under Chinese law, courts retain discretion to decide when a party can back out of contract responsibilities.

Force majeure, "superior (or irresistible) force", is when part or the entirety of a contract "cannot be performed due to causes which are outside the control of the parties and could not be avoided by exercise of due care." It is similar to, but subsumes, "act of God", or *vis major*, which refers to natural disasters.[130] In the context of China,

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[125] See Wang, *supra* note 115 at 85-87.

[126] See Wang, *ibid.*; L. Wang, "Yuqi Weiyue Zhidu Ruogan Wenti Yanjiu" ["Research on Some Problems of the System of Anticipatory Breach of Contract"] [1995] no. 2 *Zhengfa Luntan [Tribune of Political Science and Law]* 18; Liang, *supra* note 4 at 115.

[127] See *e.g.* the comments made by Jiang, *supra* note 4 at 251.

[128] Art. 27.

[129] 1993 Contract Law, *supra* note 3, art. 26.

[130] *Black's Law Dictionary*, *supra* note 11 at 33 ("act of God"), 645 ("*force majeure*") and 1572 ("*vis major*").

the first question that must be asked is, can the actions of state officials and planners count as *force majeure*? Many contracts depend on inputs, financing and licenses from state organs. Does refusal of a state official to provide these things constitute *force majeure*? Courts in fact frequently applied the 1982 provision permitting changes in contracts due to the state plan (especially price changes).[131] Would such changes now be considered *force majeure*? If so, how close can a relationship between an enterprise and the state officials responsible for such policy changes be before *force majeure* no longer applies? Clearly, the opportunity exists for enterprises and ministries to collude in using *force majeure* to relieve enterprises of their obligations, especially with so many pricing and planning decisions devolved to provincial or local officials. The doctrine of *force majeure* as it appears in Chinese law does not resolve these issues.

Chinese law merely defines *force majeure* as "objective conditions" (*keguan qingkuang*) that are "unforeseeable" (*buneng yujian*), "unavoidable" (*buneng bimian*), and "insurmountable" (*buneng kefu*).[132] But no legislation, regulations or legal interpretations say whether the actions of planning officials fall inside or outside of these categories. Moreover, the phrase *buneng* ("not able") in each of the three major conditions elides a distinction that has assumed great importance in Anglo-American law: impossible versus impracticable. "[A] thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost."[133] *Buneng* can mean either. Courts are thus able to invoke the standard of impossibility when they want to make it difficult for a party to avoid specific performance, and a more relaxed standard like impracticability when they want to relieve a party of certain obligations. Indeed, courts have been known to permit stronger, state-connected parties wider latitude for nonperformance despite propaganda supporting consistent, objective enforcement.[134]

In sum, a negotiated price for contract termination is vulnerable to myriad legal grounds for ordering specific performance — social good, the request of one party, indirect orders from planners, etc. In this vein, judicial discretion generated by ambiguity in the doctrine of *force majeure* may allow the state to pick and choose when performance is required. Just as importantly, it provides opportunities for enterprises to parlay even indirect connections with planning authorities into real status inequalities. By colluding with planners, or even local courts, such enterprises may not be held to contract terms as strictly as their co-contractants. All in all, the 1993 Contract

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[131] *E.g.*, [1988] no. 2 *Zhonghua Renmin Gongheguo Zuigao Renmin Fayuan Gongbao* [*Gazette of the Supreme People's Court of the PRC* 16 [hereinafter *Supreme Court Gazette*]. See also L. Ross, "Force Majeure and Related Doctrines of Excuse in Contract Law of the People's Republic of China" (1991) 5 J. Chinese L. 58 at 96; P.B. Potter, *supra* note 103 at 344.

[132] *General Principles of Civil Law*, *supra* note 10, art. 153. Article 24 of the 1985 Foreign Contract Law, *supra* note 3, essentially restates this definition.

[133] *Black's Law Dictionary*, *supra* note 11 at 755 ("impossibility").

[134] On propaganda, see D. Zweig *et al.*, "Law, Contracts, and Economic Modernization: Lessons from the Recent Chinese Rural Reforms" (1987) 23 Stanf. J. Int'l L. 319; on reality, see Ross, *supra* note 131.

Law does not clearly do a better job of upholding principles of free negotiation and equal status than its 1982 counterpart. Obvious references to planning have been omitted, but the loopholes have not been plugged. "Principled ambiguity" permitting official interference in contracts continues to pervade the state's legal framework. Its vision of even "civil law" freedom of contract is, ultimately, still tentative and based less on individual rights than on state guidance of the economy.

V. Dispute Resolution: Vertical and Horizontal Pressures

Freedom of contract requires that contracts be enforceable at law. Also, institutional economists view enforcement as perhaps the most salient aspect of contracts. Without reliable, impartial and predictable dispute resolution and enforcement, they postulate, the ability of contracts to foster long-distance and impersonal trade will be impaired.[135]

Excluding extremely informal mediators (like clan leaders, neighbours, relatives and friends), dispute-resolution bodies, or forums, in China include: (1) People's Mediation Committees (*Renmin Tiaojie Weiyuanhui*) ("Mediation Committees"); (2) common administrative superiors ("superiors") (typically a ministerial official); (3) the Commerce Bureau; and (4) People's Courts ("courts"). In the countryside, Party secretaries, public-security officials, and brigade leaders sometimes still conduct mediation, but this study focuses on urban China.[136]

Among these four forums, China (like Western nations) recognizes three modes, or types, of dispute resolution: mediation (*tiaojie*), arbitration (*zhongcai*) and adjudication (*shenpan*). Each is recognizable to its Western counterpart but may function very differently. Mediation involves a third party who helps bring the parties to voluntary agreement but (in theory) lacks authority to impose a solution. Arbitration involves a non-judicial body who by the parties' agreement — usually by a pre-arranged "arbitration clause" in the contract — may impose a solution. And adjudication involves a court that enjoys jurisdiction despite the wishes of the parties and possesses authority to impose a solution.

In China, Mediation Committees may only mediate. Superiors may conduct mediation or, in some cases, something akin to arbitration. The Commerce Bureau is the primary arbitral body, operating through its Economic Contract Arbitration Committees (*Jingji Hetong Zhongcai Weiyuanhui*) ("Arbitration Committees").[137] Theoreti-

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[135] See D.C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990), especially at 121. See also O.E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985).

[136] On the *de facto* mediation authority of these officials, see D. Barnett, *Cadres, Bureaucracy, and Political Power in Communist China* (New York: Columbia University Press, 1967); S.M. Huang, *The Spiral Road: Change in a Chinese Village Through the Eyes of a Communist Party Leader* (Boulder, Colo.: Westview Press, 1989).

[137] The 1993 Contract Law, *supra* note 3, art. 42, declares that parties may use "arbitral organs", which are defined as Commerce Bureau Arbitration Committees in "Zhonghua Renmin Gongheguo Jingji Hetong Zhongcai Tiaoli" ["Regulations of the PRC for Arbitration over Economic Contracts"],

cally, Arbitration Committees may also be used for mediation. Courts, though required in civil cases to first attempt mediation, alone possess authority to adjudicate.[138]

Aside from a requirement in the 1982 Contract Law that parties attempt consultation before availing themselves of any other method of dispute resolution, the 1982 and 1993 Contract Laws both grant parties great discretion in choosing a dispute-resolution forum. They may attempt mediation first. If it fails or if they are not willing to submit to mediation, they may go directly to the Commerce Bureau for arbitration, or even directly to court for adjudication.[139] Determining how and when these options can actually be exercised requires a closer look at each forum.

A. People's Mediation Committees

After the communists took power, all independent associations eventually either became state associations or were eliminated, and mediation bodies were no exception. Of the three modes of dispute resolution, mediation in China perhaps differs most from its Western incarnation. Anglo-American law recognizes mediation as a "[p]rivate, informal dispute resolution process in which a neutral third person, the mediator, helps disputing parties to reach an agreement [and] [t]he mediator has no power to impose a decision on the parties."[140] Although mediation in China is informal, Mediation Committees are not private and mediators seem to possess authority to impose decisions or make their decisions virtually binding. It is estimated that up to ninety percent of civil disputes are resolved through Mediation Committees and other informal (ministerial, enterprise, etc.) mediating bodies.[141]

From the founding of the P.R.C., Mediation Committees have been an important organization for sociopolitical control at the local level, part of the system of "comprehensive control" (*zonghe zhili*). Although the government refers to the activity of Mediation Committees as informal or "mass" (*qunzhong*) mediation — as opposed to the formal or "judicial" (*fayuan*) mediation that occurs in court — Mediation Committees in fact operate under the direct bureaucratic control of local sections of the Ministry of Justice. They merely receive guidance from local governments and basic-level courts.[142] Their day-to-day work is guided by a locally appointed "judicial

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promulgated August 1983 by the State Council, in FitzGerald, ed., *supra* note 3, vol. 2 (*Business Regulation*) para. 10-620.

[138] The "principle of 'emphasizing mediation'" ("*zhuozhong tiaojie*" *de yuanze*) is described in Liu, ed., *supra* note 53 at 909. It is set out in *Zhonghua Renmin Gongheguo Minshi Susong Fa* [*Code of Civil Procedure of the PRC*] [hereinafter *PRC Code of Civil Procedure*], adopted April 1991, in Fitzgerald, ed., *ibid.*, vol. 3 (*Business Regulation*) para. 19-201.

[139] See 1982 Contract Law, *supra* note 3, art. 48, and 1993 Contract Law, *supra* note 3, art. 42.

[140] *Black's Law Dictionary*, *supra* note 11 at 981 ("mediation").

[141] M. Palmer, "The Revival of Mediation in the People's Republic of China: (1) Extra-Judicial Mediation" in W.E. Butler, ed., *Yearbook on Socialist Legal Systems, 1987* (Dobbs Ferry, N.Y.: Transnational, 1987) 219 at 223 n. 14.

[142] See "Renmin Tiaojie Weiyuanhui Zanxing Zuzhi Tongze" ["Provisional Organizational Principles for People's Mediation Committees" [hereinafter Mediation Principles] in *Zhongyang Renmin Zhengfu Faling Huibian* [*Compilation of Laws and Decrees of the Central People's Government*]

assistant" (*sifa zhuli yuan*) who operates under the leadership of the local Ministry of Justice.[143] Most are established by Residence Committees (*Jumin Weiyuanhui*) in cities and by Villagers' Committees (*Cunmin Weiyuanhui*) in the countryside, but they also exist as "mediation small groups" (*tiaojie xiaozu*) in factories and among every ten households in a village.[144] They are charged with upholding Party policy, they channel information to the Party, they have close relations with local police, and most mediators are Party members.[145]

In light of how Mediation Committees are organized, it is perhaps not surprising that they often violate their own avowed "principle of voluntariness" (*ziyuan yuanze*) and act more as arbitrators than as mediators.[146] That settlements are imposed is suggested by peculiar reports that parties "repudiate" (*fanhui*) or "refuse to accept as final" (*bufu*) mediation agreements. In fact, judicial assistants have in practice often gone beyond "guiding" the work of Mediation Committees and imposed settlements. Far from being seen as an aberration, some scholars have actually defended this practice.[147] And judicial assistants have *de facto* authority to impose decisions in minor cases because courts will simply not accept them for adjudication. In a way, then, "Mediation Committee" is a misnomer; these bodies are more like small-claims courts.[148]

Because Mediation Committees are extensions of the Party-state, they can neither develop nor adhere to their own professional standards. That is, how they resolve disputes is always a function of the current policy line. During the Cultural Revolution conflicts were politicized, used for mobilizing the masses. Mediation, in the sense of meeting your opponent halfway, was condemned as pernicious promotion of "class harmony" (*jieji tiaohe*).[149] Persons combating "rightist tendencies", or those with good class backgrounds, were encouraged never to compromise. Mediators sided with the party who was convincingly more "left".

In the Deng era the pendulum has swung the other way. "Compromise" (*rang*) is now encouraged. Class conflict is downplayed. The state views mediation as a tool

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(January-September 1954) (Beijing: Legal Press, 1954) 47, arts. 2 and 10; "Renmin Tiaojie Weiyuanhui Zuzhi Tiaoli" ["Regulations on the Organization of People's Mediation Committees" [hereinafter Mediation Regulations], issued June 1989 by the State Council, in *PRC Compendia of Laws*, *supra* note 46 (1989) 131, art. 12.

[143] Mediation Regulations, *ibid.*, art. 2.

[144] See Palmer, *supra* note 141 at 269.

[145] On personnel and organization, see Stanley Lubman's pathbreaking "Mao and Mediation: Politics and Dispute Resolution in China" (1967) 55 Calif. L. Rev. 1284.

[146] The argument that follows is made by D.C. Clarke in "Dispute Resolution in China" (1991) 5 J. Chinese L. 245. That Mediation Committees should follow the principle of voluntariness is stipulated in the *PRC Code of Civil Procedure*, *supra* note 138, art. 16.

[147] See Z. Yao, "Sifa Xingzheng Tiaojie Caijuequan Chuyi" ["A Preliminary Discussion of Adjudication Powers in Judicial Administrative Mediation"] [1986] no. 2 *Faxue* [*Jurisprudence Monthly*] 38.

[148] See Clarke, *supra* note 146 at 293.

[149] J. Wang, "Renmin Tiaojie zai Zhongguo de Yanxu he Fazhan" ["The Continuity and Development of People's Mediation in China"] [1985] no. 6 *Faxue Yanjiu* [*Studies in Law*] 28 at 30, *passim*.

for soothing the jealousies, called "red-eye disease" (*hongyan bing*), that have accompanied Deng's policy of "let some get rich first".[150] Rather than *replace* courts' legal formality with class struggle, Mediation Committees now work *with* courts to reduce their caseloads and foster a sense of legality. In line with a re-emphasis on Mao's more conciliatory writings, civil matters like contract disputes are called "nonantagonistic" contradictions "among the people" (not "antagonistic" contradictions "among the people and the enemy") which should be resolved using persuasion (not coercion).[151] But mediators have understandably been confused by the tension between upholding contractors' lawful rights and "soothing" conflicts. In the mid-1980s, mediators were finally told to stop using the term *tiaohe* ("conciliation"), which implies exalting social harmony and forcing compromise at the expense of individuals' rights, and start using *tiaojie* ("mediation"), which implies discerning right from wrong and adhering to the principle of voluntariness.[152] The habit of imposing solutions based on Party policy can be expected to die hard, however, especially among older mediators.

Although mediation agreements are not supposed to be legally binding, a party who hopes to challenge a mediation agreement that was coerced or is otherwise unsatisfactory faces serious obstacles.[153] Appeals are first referred back to the Mediation Committee's judicial assistant, who is charged to uphold any agreement that does not violate "law or policy".[154] Appeal after this point is impossible for smaller cases because, again, courts will not accept them. If one's case is large enough, one may appeal to court, but only if the other party reneges on the mediation agreement (or never agreed to submit to mediation in the first place).[155] And, once in court, judges seem much more likely to enforce the original agreement than allow it to be amended. Both the Mediation Regulations and the *Code of Civil Procedure* indicate parties "should" (*yingdang*) carry out mediation agreements.[156] Recall from earlier discussion of breach fees and specific performance that *yingdang* may be interpreted as an admonition ("ought to") or an imperative ("must").[157] Although no law formally defines *yingdang* in this context, authoritative legal textbooks have interpreted it as "must".[158] At any

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[150] See examples in Palmer, *supra* note 141 at 246-47, nn. 93-97.

[151] This of course refers to Mao's speech, "On the Correct Handling of Contradictions Among the People" (27 February 1957) in *Selected Readings from the Works of Mao Tse-tung* (Peking: Foreign Languages Press, 1967) 350.

[152] See W.D. Ji, "Fazhi yu Tiaojie de Beilun" ["A Contrary View of Legality and Mediation"] [1989] no. 5 *Faxue Yanjiu* [*Studies in Law*] 21.

[153] On supposed lack of bindingness, see Liu, ed., *supra* note 53 at 909: "they do not possess legal effect" (*bu juyou falüshang de xiaoli*).

[154] See "Minjian Jiufen Chuli Banfa" ["Procedures for Handling Disputes Among Citizens"], issued April 1990 by the ministry of justice, in *Zhonghua Renmin Gongheguo Guowuyuan Gongbao* [*Gazette of the State Council of the PRC*] [hereinafter *State Council Gazette*], no. 16 (28 August 1990) 597, arts. 4 and 18(1).

[155] See *PRC Code of Civil Procedure*, *supra* note 138, art. 16.

[156] Mediation Regulations, *supra* note 142, art. 9; *PRC Code of Civil Procedure*, *ibid.*

[157] See text above, accompanying note 112.

[158] In a legally nonbinding but authoritative annotation to art. 48 of the 1982 Contract Law, a 1986 legal handbook averred, "if the parties reach a new agreement through mediation, this agreement

rate, article 16 of the *Code of Civil Procedure* states merely that if a Mediation Committee "violates law" (*weibei falü*) in mediating a dispute, the court should "put it right" (*jiuzheng*).

In short, Mediation Committees are an extension of the party-state. Mediators are guided by the policy of the moment, not professional standards intrinsic to the practice of mediation. And imposed or unsatisfactory mediation agreements are difficult to challenge in court. Rhetoric aside, Chinese mediation is thus fundamentally different from the Western ideal of private, voluntary, nonbinding mediation. Its differences do not derive merely from informal bargaining and power dynamics, however, but are a direct result of how the state organizes Mediation Committees and the formal rules it uses to govern them and their relation to courts.

B. Common Administrative Superiors ("Internal" Dispute Resolution)

Especially under the planned economy, "internal" dispute resolution — resolution by a body that is organizationally related to the parties and affected financially by the dispute's outcome — was the norm. In 1950, a three-tiered system of dispute resolution was established:[159] (1) "consultation" (*xieshang*) between the management (i.e., ministerial) offices of the enterprises involved. If they could not agree, either party could (2) appeal to a district or, if they were from different districts, a prefectural finance committee. Finally, in rare cases, they could (3) appeal to court. 1963 regulations reiterated that dispute resolution involving factory and mining-goods contracts should take the form of mediation by higher-level management or arbitration by the economic committee concerned.[160]

Ministerial superiors and finance or economic committees exemplify the same sort of "internal" dispute resolution that a corporate president engages in when she resolves a dispute between two wholly-owned subsidiaries. The interests of the organization are generally placed above the rights of the parties or the terms of the agreement. In "internal" dispute resolution, considerations "external" to the contract govern. "Both parties can be viewed as pockets of their common superior, and the decision how much to take from one pocket and put in the other is decided by considerations such as convenience and efficiency, not justice and fault."[161] The entire economy under planning thus approximates what institutional economists call "unified governance": transactions do not truly take place across a market interface, for they are governed by a single authority who can resolve disputes by fiat.[162]

Resolution by an administrative superior continues today for certain classes of contracts. A common governmental administrative superior is automatically granted jurisdiction to mediate trade disputes between state and collective enterprises, and

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should be viewed as a new contract which possesses legal binding force on both parties" (Li, ed., *supra* note 3 at 217).

[159] See Provisional Methods, *supra* note 18, art. 10; Decision, *supra* note 19, art. 4.

[160] Ordering Regulations, *supra* note 32 at 53, art. 36.

[161] Clarke, *supra* note 146 at 248-49.

[162] See Williamson, *supra* note 135 at 75-79.

mediation agreements between enterprises within a ministerial "system" (*xitong*) must be carried out on pain of disciplinary sanction.[163] Such "mediators" are instructed to "enable" (*shi*, also meaning "cause" or "make") parties to resolve their dispute based on Party and state programs and policies in ways "beneficial" (*youliyu*) to construction of the "four modernizations".[164] Yet private enterprises trading across systems may forgo mediation by an administrative superior, and even an intraministerial dispute may be brought to the Commerce Bureau or court if the internal mediator cannot resolve it. If societal economic actors are increasingly choosing to use "external" forums, that may mean they are viewing contracts in terms of rights that merit strict enforcement. That is, they are rejecting "internal" forums' use of "external" considerations. Although some research has addressed contractors' changing preferences regarding different dispute-resolution forums, results have been inconclusive, inconsistent or difficult to interpret.[165]

C. The Commerce Bureau: Economic-Contract Arbitration Committees

Shortly after Deng's ascension to power, Commerce Bureau offices were granted supervisory authority over certain industrial contracts and commercial contracts (*e.g.*, contracts among factories, their wholesalers, supply and marketing cooperatives, and retail outlets).[166] While intraministerial industrial contracts remained under the supervision of economic committees, the Commerce Bureau was established as an interagency organ that handled transactions that cut across vertical ministerial systems.[167] The gradual move from ministerial to Commerce Bureau supervision is reflected in differences between the 1982 and 1993 Contract Laws. Under the 1982 law, both Commerce Bureau offices and ministries were charged with contract "supervision and inspection" (*jiandu jiancha*). In addition, ministries were to establish targets for and check up on enterprises' contract performance.[168] Under the 1993 Contract Law, Commerce Bureau offices are the only institution named as responsible for contract "supervision" (*jiandu*). "Inspection" and target-setting are not mentioned at all.[169]

The bindingness of Commerce Bureau arbitration was also strengthened under the 1993 Contract Law, bringing it more in line with Western arbitration practices.

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[163] "Shangye Jingji Jiufen Tiaojie Shixing Banfa" ["Trial Procedures for the Resolution of Commercial Economic Disputes"], promulgated November 1989 by the Commerce Bureau, in *PRC Compendia of Laws*, *supra* note 46 (1989) 267, arts. 10 and 19.

[164] Wang, *supra* note 80 at 1359.

[165] See Potter, *supra* note 25; my Ph. D. dissertation, *supra* note 96.

[166] "Gongshang Xingzheng Guanli Zongju Guanyu Gong Shang, Nong Shang Qiye Jingji Hetong Jiben Tiaokuan de Shixing Guiding" ["Provisional Regulations of the Central Commerce Bureau Concerning the Basic Provisions in Contracts Between Industrial and Commercial Enterprises and Between Agricultural and Commercial Enterprises"] in *Compilation of Economic Contract Laws*, *supra* note 18, 107.

[167] See Potter, *supra* note 25 at 52.

[168] 1982 Contract Law, *supra* note 3, art. 51.

[169] 1993 Contract Law, *supra* note 3, art. 44. However, supervision responsibilities are shared with "other relevant competent departments of the People's Government at the county level or above" (1993 Contract Law, *ibid.*).

The 1982 Contract Law permitted arbitration judgments to be appealed to court within fifteen days of being issued; arbitration judgments may not be appealed under the 1993 law.[170] The state has been urging contractors to include in their contracts "arbitration clauses" that stipulate whether disputes are subject to Commerce Bureau arbitration or court adjudication. Official policy encourages arbitration (most contracts, however, still do not even contain arbitration clauses; of those, it is unknown what percentage opt for arbitration).[171] As administrative bodies, Arbitration Committees are probably not subject to rules of evidence or a principle of adherence to law as stringent as those which apply to courts. In addition, since Commerce Bureau offices also register business enterprises and regulate trade, they have an (albeit tenuous) "internal" relation to contractors.[172] State strengthening of arbitration judgments and promotion of arbitration clauses may thus be interpreted one of two ways: either as willingness to let parties freely decide who will resolve their disputes, or as an effort to reassert administrative control over contracts.

All dispute-resolution bodies — Arbitration Committees and courts included — are instructed to begin the process of dispute resolution with mediation. Mediation carried out under Arbitration Committees is perhaps even less like Western notions of mediation, however, than mediation carried out under Mediation Committees. A recent Commerce Bureau contract reference book describes Arbitration Committee mediation as "arbitration-mediation" (*zhongcai tiaojie*) and states,

> Only if mediation is unsuccessful can arbitration be carried out. ... This is an important "symbol" (*biaozhi*) of the difference between our country's arbitration system and the arbitration systems of capitalist countries.
>
> Mediation during arbitration activities and arbitration are two different stages in a "unitary process" (*tongyi jincheng*). ... Mediation should "permeate" (*guanchuan*) the arbitration process from start to finish.[173]

That is, Commerce Bureau mediation is subsumed into an essentially arbitral process. It might be somewhat unclear whether mediation agreements reached through Mediation Committees or internal supervisors are enforceable in court, but Arbitration Committee "mediation agreements" definitely are. In this they differ in name only from Arbitration Committee "arbitration agreements". The distinction between mediation and arbitration under the Commerce Bureau is thus very slippery; it may well be that even cases brought for mediation are ultimately subject to arbitration. Indeed, mediation is described merely as a "litigation process" (*shenli guocheng*) by which Arbitration Committees handle cases.[174] These facts suggest Arbitration Committees have more power to impose solutions than some propaganda implies. They also suggest that Chinese statistics on the proportion of cases resolved through mediation (measured by "mediation agreements") must be interpreted cautiously.

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[170] Compare 1982 Contract Law, *supra* note 3, art. 49, and 1993 Contract Law, *ibid.*, art. 42.

[171] 1993 Contract Law, *ibid.*, arts. 42 and 43.

[172] This point is emphasized repeatedly in Potter, *supra* note 25.

[173] Wang, *supra* note 80 at 1361.

[174] *Ibid.* at 1360-62.

It is difficult to know much more about the workings of arbitration, however, because the Commerce Bureau does not publish cases and businesspersons are often secretive about such dealings (one reason they may have chosen arbitration in the first place).

D. People's Courts: Neither Administration nor Law

China has 3,000-odd Basic-level People's Courts at the county level. The next highest courts are the Intermediate-level People's Courts at the prefectural level, followed by the Higher-level People's Courts at the provincial, autonomous region, or centrally-administered city level. The Supreme People's Court rarely hears cases; it generally comments on cases already ruled on by provincial courts.[175] Regarding contracts, courts have two important functions: resolving disputes and enforcing the decisions of other types of dispute-resolution forums. Only courts possess the power of enforcement (*e.g.*, one must bring suit in court to force a party to live up to an arbitration agreement). Dispute resolution and enforcement are discussed in turn. Special attention is paid to constraints on court impartiality.

Parties may bring a contract case to court if they cannot reach agreement through mediation or if either party is unwilling to submit to mediation or arbitration.[176] A court will first mediate the dispute.[177] Somewhat ironically, agreements reached through court "mediation" are considered voluntary and therefore, unlike adjudicated settlements, cannot be appealed.[178] An adjudicated settlement, by the doctrine "the second trial is the final trial" (*liang shen zhong shen*), may be appealed one time.[179] Judges can thus make their decisions more binding by pressuring parties to accept a mediated settlement. For this, they can use techniques similar to those of magistrates in imperial China such as "telegraphing" their likely decisions, forcing parties to settle "in the shadow of the law".[180]

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[175] See "Zhonghua Renmin Gongheguo Renmin Fayuan Zuzhi Fa" ["Law of the PRC on the Organization of People's Courts"], amended, *PRC Compendia of Laws*, *supra* note 46 (1983) 4.

[176] 1993 Contract Law, *supra* note 3, art. 42.

[177] *PRC Code of Civil Procedure*, *supra* note 138, art. 9. In trying contract cases they "must" (*bixu*) follow "the principle of "emphasizing mediation"' ("*zhuozhong tiaojie*" *de yuanze*) (Liu, ed., *supra* note 53 at 909).

[178] See M. Palmer, "The Revival of Mediation in the People's Republic of China: (2) Judicial Mediation" in W.E. Butler, ed., *Yearbook on Socialist Legal Systems, 1989* (Dobbs Ferry, N.Y.: Transnational, 1989) 145 at 161.

[179] See M.Y.K. Woo, "The Right to a Criminal Appeal in the People's Republic of China" (1989) 14 Yale J. Int'l L. 118. Woo describes a procedure called *shensu* ("petition" or "appeal") whereby a party can ask the court or its superior court to re-examine a case after the second trial. It appears to apply only to criminal cases and, even then, is rarely used. Standards governing *shensu* do not appear to be published.

[180] Qing era magistrates' use of "telegraphing" during the stage after a plaint was filed but before judgment was rendered is discussed in P.C.C. Huang, "Between Informal Mediation and Formal Adjudication: The Third Realm of Qing Civil Justice" (1993) 19 Modern China 251, especially at 266, 275-78. A worthwhile theoretical discussion of settling disputes "in the shadow of the law" may be found in M. Galanter, "Justice in Many Rooms: Courts, Private Ordering, and Indigenous Law"

Like so many organizations in China, courts are situated within a web of vertical and horizontal interests. Vertical pressures arise from the bureaucratic position of the entire court system in Communist ideology and organization. Again, the N.P.C. Standing Committee, not courts, is responsible for judicial interpretation. "Judicial independence" in China means that individual courts are independent from other administrative hierarchies, not from higher courts.[181] The Constitution designates the Supreme Court the highest "judicial organ" (not the highest "court") and allows it to "supervise" lower-level courts, suggesting it exercises "the adjudicatory aspect of the state's unified power".[182]

From the top of this judicial hierarchy, the Supreme Court, in its regularly published *Gazette*, issues comments on and amendments to provincial-level decisions that indicate to what extent they are models to be followed.[183] These "precedent-like" statements differ significantly, however, from the principle of *stare decisis*. *Stare decisis* holds that once a court decision settles a point of law, the same interpretation shall be applied to all cases with similar facts coming before that and lower courts.[184] In China, no court but the Supreme Court may publish its decisions; higher-level and intermediate-level courts therefore cannot issue "precedent".[185] Might such decisions circulate through internal channels and form a sort of "secret" precedent? Possibly, but we simply do not know. Lower courts are prohibited from citing even Supreme Court comments and opinions (*i.e.*, those they are instructed to follow!).[186] It seems unlikely they would be instructed to follow lower-court rulings, but they might do so anyway.

In the end, since courts do not publish their decisions, and since, even if they did, they could not cite Supreme Court opinions, it is impossible to know how Supreme Court "precedent-like" statements influence lower courts. We do know that the Anglo-American "principle of 'following precedent'" (*"zunxun xianli" de yuanze*) has been criticized as ill-suited to China on the grounds that it allows obscure precedents to be misused to subvert the intent of the law.[187] In addition, in 1986 the president of the Supreme Court stated that the purpose of printing decisions in the *Gazette* is to

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(1981) 19 J. Legal Pluralism 1, which traces the phrase to R.H. Mnookin & L. Kornhauser, "Bargaining in the Shadow of the Law: The Case of Divorce" (1979) 88 Yale L.J. 950.

[181] See Cohen, *supra* note 48.

[182] Finder, *supra* note 49 at 148. See also Constitution, *supra* note 45, arts. 123 and 127.

[183] See N.P. Liu, "'Legal Precedents' with Chinese Characteristics: Published Cases in the Gazette of the Supreme People's Court" (1991) 5 J. Chinese L. 107 at 121.

[184] *Black's Law Dictionary*, *supra* note 11 at 1406.

[185] "Guanyu Difang Geji Renmin Fayuan Buying Zhiding Sifa Jieshixing Wenjian de Pifu" ["Instruction that Lower Courts at Each Level Should Not Issue Any Documents Concerning Judicial Interpretations"] [1987] no. 2 *Supreme Court Gazette*, *supra* note 131, 19.

[186] Liu, *supra* note 183 at 122 n. 61, citing an unpublished 1986 Supreme Court "reply" (*pifu*).

[187] G.Z. Chen & Z.Q. Xie, "Guanyu Wo Guo Jianli Panli Zhidu Wenti de Sikao" ["Observations on the Question of Establishing a Legal Precedent System in China"] [1989] no. 2 *Zhongguo Faxue* [*Chinese Legal Science*] 86 at 91-92.

enhance "specific guidance" (*juti zhidao*), not to set "precedent".[188] The Party-state appears to be making a distinction between decisions that have authority over lower courts, and decisions that have authority over lower courts, legislative branch interpretations, and new legislation. The former are permissible; the latter are not. That is, Supreme Court decisions are not permitted to form a body of authoritative, self-referential, and internally consistent doctrine independent from and binding on the Party. There is a distinct resemblance between the Party's use of Supreme Court opinions and imperial-era case compilations that only assumed precedent-like status after receiving the Emperor's imprimatur. "Precedent" as Party guidance is quite different from *stare decisis*.

Vertical pressures to adjudicate according to Party policy or the wishes of higher-level courts are therefore securely institutionalized. Yet vertical pressures on courts to rule in a biased manner in contract disputes are usually exerted from mid-level (especially provincial) Party Committees, not the centre. This is reflected in endemic complaints of "local protectionism" (*difang baohuzhuyi*) among courts. That is, in a dispute between a local and non-local enterprise, a court will often give more weight to the effect on local finance and employment of a local firm bearing liability than to the letter of the contract or equity. Local protectionism is not necessarily a symptom of a weakened centre or state disintegration, as many assume. As Li Jianqiang has argued, the root cause of local protectionism is post-Mao cadre-promotion policy. Essentially, cadres now win promotion by attaining higher economic growth in their province and contributing more revenue to the central coffers.

> When this standard for judging local leaders cannot be challenged, what provincial leaders ... can do is to use all means within their jurisdiction to strive for economic growth. ... It is economic growth rather than their cooperation with other regions that is judged by the Center.[189]

Regional competition, in short, affirms the centre's policies and authority; it doesn't challenge them. What are the organizational links between courts and local authorities that engender this dynamic of inter-court local protectionism?

The fundamental source of court protectionism seems to be that, although they belong to a hierarchy of higher courts, local courts are financed and staffed at the local level. Courts at each level are under the control of the corresponding People's Government (court presidents, for example, are appointed by local People's Congresses). Judicial appointments lack any sort of tenure so judges may be removed at any time. Judges are thus beholden to the local People's Government which is in turn subordinate to the local Party Committee. Judges are dependent on local Party and government organs for their jobs, benefits, housing, promotions, bonuses, and even employment of their children. As one legal official wrote, "This personnel power ex-

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[188] T.X. Zheng, "Zuigao Renmin Fayuan Gongzuo Baogao" ["Work Report of the Supreme Court of the PRC"], presented to the N.P.C., 8 April 1986, in [1986] no. 2 *Supreme Court Gazette*, *supra* note 131, 3 at 11.

[189] J.Q. Li, "Regionalism without Regional Identity: Provincial Leaders and Inter-regional Competition in the PRC" (Paper presented at the annual meeting of the Western Conference of the Association for Asian Studies, Ogden, Utah, 24-26 October 1996) at 21.

ercised by a small group of leaders hangs like the sword of Damocles over those who would do things according to law."[190] It is also unknown how widely the Mao-era doctrine of "approval of cases by the local Party Secretary" (*shuji pi an*) is still practiced. Though now considered irregular, the Supreme Court mandated it for cases involving foreigners as late as 1979.[191] Moreover, the decisions of individual judges who actually hear a case may be overridden by the court president (often a member of the local Party Committee).[192] With more and more contract disputes arising between "township and village enterprises" (*xiangzhen qiye*) with direct ownership, fee and tax ties to local governments, it is hardly surprising that these organizational arrangements (combined with current cadre-promotion policy) have generated severe local protectionism among courts.

China tries to minimize these conflicts of interest in contract cases through a doctrine called "avoidance" (*huibi*). It is unclear how it could actually be very useful, though. It holds that if judicial officials or their relatives are parties to a dispute, stand to profit from the result of a case, or have a relationship to the disputants that may influence their impartiality, they may dismiss themselves from hearing the case. But counties have a financial interest in any dispute involving a township-owned enterprise or even a private enterprise that pays taxes and fees. Since county officials can harass or fire judges, judges conceivably stand to profit (or lose) from any commercial case they hear. They certainly have a relationship *to individuals who have a relationship* with the disputants that may influence their impartiality. Avoidance might be more effective in Intermediate-level People's Courts, which are the courts of first instance in cases that have a "major influence" (*zhongda yingxiang*) in a locality (*i.e.*, which involve large sums of money, or influence fulfillment of plan targets).[193] Local protectionism may be weaker because the relationship between local finance and the corresponding level of government under which intermediate courts function may be much more tenuous.[194] But most disputes will go to basic-level courts.[195]

The ultimate Achilles heel of impartial court adjudication seems to be the Party-state's desire to preserve "principled ambiguity" in the law. Principled ambiguity maintains flexibility for Party intervention. Party policy can decisively influence the implementation of the law without explicitly contravening it. Maintaining principled ambiguity requires maintaining a monopoly over legal interpretation. An integral

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[190] Quoted in Clarke, *supra* note 146 at 263.

[191] See "Renmin Fayuan Shenpan Minshi Anjian Chengxu Zhidu de Guiding (Shixing)" ["Rules on the System of Procedure in the Adjudication of Civil Cases by People's Courts"], issued 2 February 1979, art. 2, cited in Clarke, *supra* note 146 at 261-62, n. 58.

[192] See "Law of the PRC on the Organization of People's Courts", *supra* note 175, art. 11.

[193] On the doctrine of avoidance and rules governing courts of first instance, see Wang, *supra* note 80 at 1420-21.

[194] See D.C. Clarke, "The Execution of Civil Judgments in China" (1995) 141 China Q. 65 at 72.

[195] This suggests that contracts are much more problematic than even the most vocal foreign critics of Beijing believe. Most cases that make headlines in the West involve non-Chinese and large sums of money. They are thus handled by higher-level courts, are subject to the more Western-oriented Foreign Contract Law, and are treated gingerly to preserve China's world image. How many smaller, domestic cases of local protectionism are never heard of?

element of principled ambiguity is thus prohibition of an independent system of precedent, or *stare decisis*. As mentioned before, courts cannot even publish their decisions or cite Supreme Court opinions. Civilian legal systems that ban precedent usually compensate with detailed codification. That is certainly not the case in China. The net effect is that judges are more likely to be left to their own devices, especially since laws and regulations are published by a bewildering array of bureaucracies, and there is no overall index. In short, the power of horizontal pressures might be considerably weaker if courts were permitted to develop a countervailing corpus of legal interpretation through *stare decisis*, but this would conflict with the fundamental constitutional principles of the Party-state. Local protectionism — and its attendant undermining of respect for contracts — is thus an unintended but direct consequence of fundamental organizational principles of Party-state rule.

The general dynamics of local protectionism combine with several other institutional arrangements to make court enforcement a serious problem in China. Although courts are the only dispute-resolution forum granted the authority to enforce or "implement" (*zhixing*) agreements or decisions, they have no general contempt power. That is, the mere refusal to carry out a court order is not in itself a criminal offense. This problem is magnified when a court tries to execute a judgment against a non-local enterprise. Some provinces have passed laws, against central policy, that require an order from a local court before local banks can freeze the assets of a local enterprise.[196] Thus, a court must often seek the cooperation of another court in the locality of the enterprise it is trying to enforce against — a court utterly dependent on its own Party and government superiors. That second court, even if it is willing, may be unable to get a local bank to cooperate. Incredibly, when the new *Code of Civil Procedure* was passed in 1991, the Ministry of Finance apparently lobbied (successfully) to abolish courts' powers to detain and imprison bank officials who refuse to cooperate with court orders to freeze or transfer funds. Courts may only issue fines, but even these must be enforced in the noncooperative party's locale.[197]

But local protectionism is not the sole impediment to enforcement that undermines the capacity of contracts to lower transaction costs. Legally-sanctioned status inequalities have not entirely disappeared. As late as 1992 courts were ordered to show "special solicitude" (in the name of social stability) when asked to execute against large and medium-sized state-owned enterprises.[198] And execution against enterprises run by the military has been called "impossible".[199]

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[196] Shenzhen apparently has such regulations (see "Dangqian Jingji Anjian Weihe Zhixing Nan?" ["Why is There Currently an Execution Problem in Economic Cases?"] *Shanghai Fazhi Bao* [*Shanghai Legal System Daily*] (2 October 1989) 1).

[197] See Clarke, *supra* note 194 at 79. See also *PRC Code of Civil Procedure*, *supra* note 138, arts. 221 and 222. For a more recent and expanded presentation of Clarke's unparalleled research, see his "Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments" (1996) 10 Colum. J. Asian L. 1.

[198] See Clarke, *ibid.* at 74, citing Guangzhou Shi Zhongji Renmin Fayuan Zhixing Ting [Guangzhou Intermediate-Level People's Court Execution Chamber], "Chongfen Fahui Zhixing Gongzuo de Zhineng Zuoyong, Genghaode Wei Shehui Anding he Jingji Fazhan Fuwu" ["Give Full Play to the

Conclusion

This overview of domestic contract law in the P.R.C. has highlighted how black-letter law or institutional arrangements structure the practical reality of entering, forming and enforcing a contract on the mainland. It is clear that the contract discourse the Chinese state has promoted under its socialist market economy diverges in fundamental ways from Western notions of freedom of contract.

The ability at will to enter a contract? The state maintains control over who may enter economic contracts through the institution of juristic personhood and restrictions on to whom and for what purpose it may be awarded. Juristic persons are not viewed as individuals writ large with bundles of inalienable rights, but as public-law creations meant essentially to serve the ends of state policy. Moreover, due to ambiguities in the registration process, the ability to obtain juristic personhood is often a function of one's personal and professional connections. Once this hurdle is cleared, one may still have to have a contract approved before courts will recognize it as binding, due in part to the absence of a well-established doctrine of offer and acceptance.

The right to order one's affairs through contracts and bargaining, and to be free of external pressures? Contrary to the spirit of its own civil law, which stresses "equal status" between contractors, the state has not given contracts clear legal protection from interference by the actions of planning officials, ministries and state enterprises. Without sophisticated legal doctrines like impracticability, courts are left with significant discretion to decide when an event falls under *force majeure*. At the same time, courts can use the doctrine of specific performance to force a party to carry out a contract even after he has paid compensation. Domestically, contractors are not permitted to freely negotiate a price for termination.

The right to enforcement? All of the forums the state provides — including those for "mediation" — possess legal and statutory powers to render their decisions binding or practically binding. Mediation Committees are suffused with pressures from the Ministry of Justice and the Party. Internal dispute resolution by a common administrative superior explicitly elevates the collective good above the rights of the parties or terms of the contract. And People's Courts are beset by a host of crisscrossing vertical and horizontal pressures that can influence their decisions; they are simultaneously prohibited from developing a corpus of legal precedents that might aid them in making more consistent, law-based judgments.

Although institutional arrangements play a crucial role in diluting legal protection for contracts, the P.R.C. continues to refine the law itself in ways that promise to bring it more in line with international practice. Yet the very rapidity with which the law changes in the P.R.C. today means that its impact on the actual practice of legal offi-

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Function of Execution Work, Serve Social Stability and Economic Development Even Better"] in *Di'er ci Quanguo Shenghui Chengshi Zhongji Renmin Fayuan Zhixing Gongzuo Yantaohui Huiyi Cailiao [Materials from the Second National Conference of Intermediate-Level People's Courts from Provincial Capitals on Execution Work]* (June 1992).

[199] Clarke, *ibid.*

cials is highly unpredictable. In the end, it is probably the institutional arrangements which will dictate continuity or change in the mainland's contract regime. If so, maintaining the uniqueness and integrity of Hong Kong's legal institutions, rather than the independence of its contract law *per se*, is probably the best guarantee that contracts in Hong Kong will continue to enjoy the legal protections they did before 1 July 1997.