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CISG and CHINA

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The CISG, as one of its aims, intends to be a uniform international law for the Sale of Goods. One author went as far as to say that the CISG is "well on the way to becoming the Magna Carta of international trade".[1]

The attempt to create a uniform set of rules is not without problems. One possible obstacle to uniformity is the fact that not the nations have developed the same level of sophistication in their international trade usage and not all nations operate under the same or a similar political system. Many writers in the early development of the CISG predicted that the loose terminology of the CISG would lead to interpretations of the CISG based on national economic, legal and political orientations.[2] In my view this prediction does not appear to become true. The growing number of court decisions indicates a move towards a uniform interpretation of the CISG. Scholarly writings of more recent vintage help this process enormously. Courts, especially in Europe, have taken notice of these writings. This view needs to be tempered by the fact that there may be a **[page 7]** difference of interpretation between developed and developing economies. These countries, and in our case China, have a more fragile trade system in place which still has not yet a clearly defined position within the political system. To add to the difficulties, Chinese law lacks published court decisions, which help to interpret statutes. Statements of ministries have been given quasi-jurisprudential status, therefore adding uncertainty to the interpretation and application of the CISG in China.[3]

"The CISG in China - Theory and Practice." Is there a difference between theory and practice?

To fully understand substantive law of a foreign country it is essential that a basic grasp of the culture of law-making and enforcing be understood. It is perhaps a good point to mention that law-making in China has seen dramatic changes after the late '70's. It was said that in the Cultural Revolution law-making ceased, however since 1979 the re-establishment of the rule of law has gathered momentum.[4] China, it appears, has also entered a new phase in its economic and legal development namely the "socialist market economy". These two factors alone have brought an enormous burden in the law-making capacity of the People's Republic of China. As a consequence, Chinese laws do not specify many relevant matters, and there are still gaps and inconsistencies in the laws and regulations. The feudal element of Chinese history is still in existence. Rule of Man and not the Rule of Law still can be found, especially in the court system where only recently appointments were made from legally trained people. The drawing up of detailed contracts can overcome some of these problems and fill the gaps.[5] This is especially true as the body of law in China is sufficiently large and there is no need any more "to reinvent the wheel each time subjects come up in negotiations."[6] The CISG has contributed towards this end.

This paper will briefly look at the general law-making process in China, followed by a discussion of the CISG as applied in China. The purpose of such a study is to establish a starting point, the description of the black letter law. Problems which emerged by the application, or lack of black letter law will be discussed to **[page 8]** establish the "legal reality" concerning the implementation practice of the CISG in China.

It should expose what is familiar to us and highlight the unfamiliar in order to appreciate legal difference, not only in substantive law, but also in philosophy and purpose of law.

I. Background: China's Legal System

During the 1980s China underwent significant changes as far as its governance is concerned. There are two features in China which are of fundamental importance, namely the Communist Party and the Constitution of the People's Republic of China (1982). The Communist Party traditionally had a pervasive involvement in the law-making process, although it

was not directly contained in the Constitution.[7] The Government and the Party are not at all separated despite the fact that it may appear so in documents. It only needs to be remembered that the Secretary General of the Communist Party, the Premier of China and the Chairman of Peoples Liberation Army are now the same man.

The amended Constitution of 1982 states in Article 5 that the Communist Party, armed forces, public organizations, enterprises and institutions in China must comply with the Constitution and other laws.[8] The Constitution therefore is the most important legal document in China. It is not unlike the Pancasilla in Indonesia. All laws relate back to the Constitution, which has supreme legal authority. The National People's Congress and its Standing Committees, as well as the State Council have legislative powers which include the following: "to annul those administrative rules and regulations, decisions or orders that contravene the Constitution or the law."[9] The major development in 1993 was the further amendment of the 1982 Constitution to accommodate new policies of the socialist market economy. Article 18 of the Constitution also states that foreign enterprises' and organizations' and Chinese-foreign joint ventures' rights and interests are protected by Chinese law.[10]

It is clear that there is a growing body of law, which has been written to establish a legal system, which will give investors confidence to put resources into China.**[page 9]**

Of importance is the observation that the bureaucratic reality in China is expressed in a vertically organized fashion.[11] As a result, China still suffers from structural deficiencies and has not yet developed a mature legal system. Cooperation across ministries, provinces or municipalities may not be easily accomplished.[12] It follows that case studies must be treated carefully. It can be safely assumed that a particular ruling is repeated if a case is brought for decision in the same department or ministry. Whether it crosses ministries, or even provinces within the same ministry, such an assumption cannot be safely made. This problem will be discussed further when we look at specific problems in the implementation of the CISG.

To understand this feature of China's legal system we need to understand that law and policy [13] have been defined as the two halves of a relationship. Law has been created in accordance with policy, but also policy is formulated within the confines of the law.[14] Like many other Asian countries, China interprets and applies laws within the confines of policy which, in general, has been formulated, by, or at least with the consent of, the Communist Party. The obvious temptation for bureaucrats is to rely on the policy decision rather than the legislation, in the knowledge that all laws, orders or directives, which are inappropriate, can be annulled by the ministries or commissions.[15] A further consideration is that most if not all higher ranking officials are party members which again would make it imperative to follow policy. Such policy decisions can very well be within the confines of the law, however law still remains within the preserve of officialdom. It is not published in sufficient quantity or completeness that its full meaning and intent can be understood by foreign observers.[16] It follows that litigation in China is not always impartial. Those who are well connected can influence outcomes or processes.**[page 10]**

To sum up it can be said that the Communist Party functions through its Central Committee down to the local committees. The National People's Congress and the Congress of the Communist Party function as the two important congress systems in China. The highest legislative body is the National People's Congress, which does take directions from the Party and passes legislation to enact these policies and directives. People's congresses function right down to local levels. The People's Congress operates through standing committees. The Council governs through 29 highest ranking administrative units. Many of these units are involved with the CISG because they all touch on various aspects of economic life in China.[17] These units again, of course, are organized on a national level down to provincial and local branch offices. All of these units establish rules and procedures in conjunction with, and in addition to, the national rules enacted by the Peoples Congress. It is not surprising that overlaps and inconsistencies among legislation have been discovered. In many countries this would in itself not be a problem, as most laws have transition, repealing or amending clauses. However, this is not the case with most legislation in China, and it tends to confuse foreign investors and even their Chinese partners. The State Council has recognized these problems and attempts are being made to streamline and coordinate the work of legislation at all levels.[18]

Keeping the above in mind, it appears that the success of an action under the CISG is best achieved through arbitration rather than litigation. Arbitration is also culturally better suited to the Chinese way of doing things. It allows saving face, a most important facet even in the interpretation of legal issues. Thought must always be given to have a suitable

Chinese partner when dealing with Chinese business. The success of many activities depends on the Chinese partner's ability to "get on" with the bureaucracy and establish good working relationships. It is difficult, or even beyond a foreigner's ability, to comprehend and work satisfactorily through these bureaucracies.**[page 11]**

II. CISG in China

It is of importance to touch briefly on a problem which needs to be considered when cross cultural interpretation and application of laws are attempted. In my view, laws can be classified into "laws of mechanics" and "laws of principle". Laws of mechanics clearly describe and regulate a fact. Article 13 of the CISG can be quoted as an example. It states that "For the purpose of this Convention "writing" includes telegram and telex." This is very clear to any person irrespective of background. Any transaction conducted by telex or telegram is deemed to have been done in writing. There is no divergence of opinion. Language, or accuracy, of language only limits mechanical laws.

Mechanical laws deal also mainly with physical concepts. Laws of principle, on the other hand, deal mainly with metaphysical concepts and in their application are dependent on an understanding and knowledge of the culture of a society. Article 7 of the CISG is a good example to illustrate this point. In brief, Article 7 uses the principle of "good faith" in the application of the Convention. What is good faith? In Australia such a concept is not known whereas in Germany "Treu und Glauben" is well established. Principles can be learned and understood, however, if the "goal posts" are shifted, understanding becomes rather difficult. In China, the goal posts were certainly shifted when the socialist market economy was introduced. It can be said that the shift has not yet finished, as China's political and economic system has not reached maturity.

China was the tenth signatory state to the CISG and pursuant to Article 99(1) the CISG became effective in China on January 1, 1988.[19] Remember that China made a declaration to exclude Article 1(1)(b) which makes the application of Chinese domestic law potentially more frequent. In effect, the CISG only replaces domestic law if both, seller and buyer, have their places of business in a contracting state.

Since that time there have been seven reported court decisions and six arbitration rulings which relied on the CISG. As China is a Contracting State, the CISG overrides domestic law. If we were discussing the effect of the CISG on domestic **[page 12]** legislation in the case of Switzerland or Australia, "to override" would certainly express the situation correctly. However, in the Chinese case, I feel that the words "to override and replace" are far too positive and final and not sufficiently fluid. In my view, the words "to modify or replace" would nearly, but not quite achieve the effect of overriding. Such "near precise" language fits much better into Chinese decision making as it allows to interpret the CISG within the confines of policy.

In essence, we are all familiar with the fact that an international contract for the sale of goods is governed basically by the CISG, and only if the CISG is either silent or the contract specifically provides so, domestic law will be applied. In any country, and China is no exception, the CISG cannot exist without the application of domestic law. However, it is interesting to note that Chinese courts quote the CISG and domestic law side by side. In many judgments, quotes such as "Applying FECL, Art. 9(1) [CISG] and relevant international usage"[20], appear frequently. When domestic law is quoted side by side with the relevant CISG articles, it is always difficult to be sure whether one or the other has been applied. It seems that this is the Chinese way of judicial writing, and it might also indicate that the CISG is not used with confidence in some courts.

A Chinese author [21] suggested that the formation of a contract, performance, compensation for losses pursuant to the CISG are all identical with the provisions of domestic law. Hence there appears to be no conflict between an application of the CISG compared with domestic law on these issues, and in many reported cases, the outcomes suggest that the CISG, had it been applied, would not have changed the result.

Domestic legislation may be identical but it does not exactly track the CISG, as it is the case in some countries. The UCC in the United States and the Sale of Goods Act in Australia are two examples for domestic legislation which does track the CISG. China has legislation on Contracts in general and not a specific law for the Sale of Goods.**[page 13]**

China had enacted two sets of Contract laws namely, the Economic Contract Law (ECL) and the Foreign Economic Contract Law (FECL). However, on March 15, 1999, China has passed a unified contract code - the Contract Law of the

People's Republic of China. The new law repealed the ECL, FECL and it should come into force on October 1, 1999. Whether the new contract law becomes applicable at that date is not clear, hence this paper considers what is presently in force. It will be of great interest to study what changes actually will take place once the new contract code comes officially into operation.

Pursuant to its Article 2, ECL applies to contracts "concluded between legal persons of equal civil standing, other economic organizations, individual industrial and commercial households and rural contracting households". It governs basically contracts between Chinese citizens. FECL on the other hand controls contracts between "enterprises or other economic organizations of the People's Republic of China and foreign enterprises, other foreign economic organizations or individuals" (Article 2 FECL). In other words, at least one of the contractual parties must be a foreign citizen. We can reasonably assume that FECL and not ECL will apply should domestic law become applicable, as pursuant to Article 1(1)(a) the CISG applies to contracts where contractual parties have their place of business in Contracting States, hence one party would need to be a foreign party. But do not take this for granted. There could be situations where ECL could be applied because it may suit the Chinese party and it is less favorable to the foreign one.

Consider the following situation. Koala Ltd., an Australian Company, intends to import goods from China. They negotiate with VicTrade Ltd., an Australian Company with their Head office in Melbourne. VicTrade Ltd. is a joint venture Partner with Gaoping FTB, a Chinese firm. The contract is with the Joint Venture Company. Article 2 of the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures using Chinese and Foreign Investment states that "Chinese-Foreign Joint Ventures are Chinese legal persons and are subject to the jurisdiction and protection of Chinese law." It would appear that FECL pursuant to Article 5 is still applicable, hence invoking the application of the CISG. As the seller is a Chinese legal person, some aspects of ECL could become applicable in conjunction with the CISG if the parties make such a stipulation.**[page 14]**

One fact remains that many provision and principles contained in the FECL are familiar to us because they are international in character and are similar to the ones found in our laws.[22] However, FECL and most of China's regulations also possess unique characteristics. Two features will be looked at briefly.

Firstly, Chinese judges or arbitrators tend to take a rather global view at the resolution of disputes rather than confine themselves to strictly legal issues. Harmony of outcome is more important than a mere application of the law. A good example can be found in a judgment where the arbitrator had to address the question of loss of profit. He found that the goods in question could be purchased elsewhere and that the price had dropped anyway, hence no award of loss of profit was appropriate.[23]

Secondly, and most important for our purpose is the fact that these regulations, which we would consider private law, contain elements of public law. It is this particular public law aspect which makes any interpretation and dispute resolution uncertain. Even if an article of the CISG were clearly applicable, it could be negatived by a higher authority on the grounds that the contract as a whole infringes on the public interest pursuant to Article 9 of FECL. How is that possible when the CISG prevails? It is of no consequence in China that the CISG in its articles declares that it will prevail over domestic law. As stated above, within the Chinese legal system policy and law are closely interrelated. Policy would dictate that any private matter which infringes on whatever is deemed to be of public interest must be set aside. The law has therefore been framed accordingly as seen in Article 9 of FECL. It is precisely for this reason that, in my view, the CISG does not prevail but modify or replace Chinese law. The theoretical picture that the CISG should prevail is contained in the laws and regulations of the People's Republic of China, but many Western firms have learned that, contrary to their lawyer's opinions, a different picture can emerge.

As mentioned above, the CISG modifies or replaces Chinese domestic law. FECL in Article 6 declares that any clause in an international treaty, in our case the CISG, will prevail over the law of the People's Republic of China. Feng **[page 15]** Datong [24] confirms the position and concludes that this will bring FECL in line with international treaties.

III. Three Prominent Issues

1. Validity

Article 4 of the CISG explicitly excludes validity of the contract. It has been described as "a potential black hole [that

removes] the issues from the Convention's universe."[25]

The debate as to the validity exception has not finished yet, but some writers suggest that it is possible to limit the meaning of "validity" to a common core of meaning, namely covering issues of illegality, incapacity, fraud, mistake and duress.[26] It appears that Chinese decisions and regulations reflect the same common core of meaning.

In CIETAC award (1995) No. 74 [27] the arbitrator used Article 9 of FECL to set one of two identical contracts aside which was made to evade customs duty which made the contract invalid. Article 9 states that "Contracts that violate the law or the public interests of society of the People's Republic of China are invalid." It is interesting to note that the arbitrator choose to declare the contract void under Article 9.

Now consider the following article of FECL. Article 7(2) stipulates that certain contracts need to be approved "by the competent authorities of the state. They are only formed when the approval is given." Only those Chinese entities, which have authority, may execute contracts directly with foreign businesses. Natural **[page 16]** persons are rarely authorized to conduct international trade".[28] The conclusion, which can be drawn, is that contracts between Chinese individuals and foreign enterprises could be void and hence invalid.

It would be a mistake to believe that Australian and Chinese treatment of validity of contracts is the same. As mentioned above, in China many private laws contain elements of public law. Article 9 is a point at hand. Any contract that violates the public interest of society and hence the People's Republic of China is invalid.

The problem is that the public interest is defined within policy, which in turn is in the domain of officialdom. Contracts should be in accordance with state policies and plans, otherwise they may be declared invalid (Article 4 FECL). In this context, it needs to be mentioned that it is still common for Party committees to organize "special case groups" to guide the conduct of important cases.[29] Furthermore, officials do rely on policy directives rather than legislation because of their elastic qualities.[30]

An interesting interplay between FECL and the CISG needs to be considered: Let us assume you have concluded a contract with a Chinese enterprise by telex. Article 12 of the CISG allows a Contracting State to vary the effects of Article 11. China has made such a reservation pursuant to Article 96 of the CISG. The effect is that Article 7(1) of FECL overrides Article 11 of the CISG.

Article 7(1) of FECL states that "A contract is formed when the clauses of contract are agreed in written form and signed by the parties." Clearly, to be valid a contract must be in writing, which is in line with China's reservation. However, Article 7(1) also contains an exemption namely if a "party requests to sign a confirmation letter when the agreement is reached by means of letter, telegram or telex, the contract is only formed upon the confirmation letter being signed." If an agreement is reached by telex or letter, the signing of a letter of confirmation is sufficient to fulfill the requirements of Article 7(1) FECL.[31] This **[page 17]** point can be illustrated by a court decision.[32] The court correctly concluded that, as there was a signed letter of confirmation, the requirements of Article 7(1) of FECL were met. The court went to explain that, despite the fact that the CISG applied, Article 11 was excluded.

2. Interpretation of the CISG

Article 7 has two limbs. Firstly, the interpretation of the CISG must be done in observance of good faith. Secondly, questions which are not expressly settled must be settled with the general principles on which they are based. In the absence of such principles, the rules of private international law prevail.

"Good faith", as a principle, is not unknown in Chinese culture. It is not expressly stated, but certainly implied in Article 3 of FECL: "contracts should be made in accordance with the principles of equality and mutual benefit and of achieving unanimity through consultation." To a lesser degree, Article 1 also supports the notion of "good faith" by stating that contract law is enacted "with a view to protect the lawful rights and interests of the concerned parties and promote the development of China's foreign economic relations."

There appear to be no problems in achieving the aims of the CISG as expressed not only in the first limb of Article 7, but in the totality of Article 7. However, we must again look back and see what has been said about a socialist market

economy. The State Plan is always put before the individual contract. That will not leave the party without remedies. If a contract cannot be performed due to the fault of higher authority, that authority will assume liability according to Article 37 of the Industrial Sales Contracts Regulation. If the higher authority fails to provide compensation, the original aggrieved party has difficulties to sue the Chinese party in breach, as it can claim protection under Chinese domestic law and under Article 79 of the CISG, a point further discussed below.

Interpretation of Article 7 of the CISG will always be subordinate to the fact that faithful performance of economic contracts serves as a means to fulfil state **[page 18]** plans.[33] The 1992 case between Ao Long Chemical Products Ltd. Australia v. Jiangxi Provincial Import and Export Co.[34] is a point at hand. After the Australian firm negotiated a sale with Jiangxi Provincial r Import & Export Co., the Chinese firm bought the goods from another Chinese firm, namely Hanyang County Textiles Import & Export Co. Jiangxi Company, and Hanyang Company would use the contracts as part of their performance under the state plan.

This leads us to an interesting area, namely the question of remedies for breach of contract. It needs to be remembered that damages under FECL are compensatory rather than punitive. This is in line with other legal systems such as the UCC. However, ECL which governs native economic transactions, bears a pronounced penal color.[35]

3. Breach of Contract

Consider the following hypothetical example:[36] Under the state plan, Gaoping FTB has to produce and supply 50,000 cases of oil as its contribution to the "foreign trade system". Gaoping was approached by an Australian firm, Koala Ltd., who was willing to pay $5 a case. FoodImpex is a selling agent who requires as its part of the "foreign trade plan" to sell 100,000 cases of oil.

Gaoping was approached by FoodImplex, who had difficulties to fulfil its quota, with an offer of $7 per case. Gaoping informed Koala Ltd. that it will cancel its contract.

There are two points to be considered. Firstly, the conclusion and performance of contracts between two Chinese firms can be a means to fulfil their respective state targets. Secondly, a contract of this nature narrows down the remedies for breach of contract, as the primary concern or consideration for these contracts is **[page 19]** not the realization of profits, but to achieve the State Plan. A Chinese party can also rely on Article 79 of the CISG by claiming that the failure to perform the contract was "due to an impediment beyond his control."

If we consider Articles 46 and 62 of the CISG, it is quite clear that the buyer has the right to request specific performance. However, this absolute right has been tempered through Article 28 of the CISG which allows any court discretionary powers to grant specific performance if the court would do so under its own domestic laws. If we go back to our hypothetical example, we could confidently argue that the court would not grant Koala Ltd. a remedy of specific performance pursuant to Article 46 of the CISG. Under domestic law, the only remedy Koala Ltd. can seek is damages. Besides, Gaoping would claim that the breach was caused by the fault of a higher planning authority that is beyond its control pursuant to Article 79 of the CISG. If, however, Gaoping would breach its contract with FoodImpex, specific performance would be granted under Chinese domestic law.

Let us analyze this situation. It is sufficient to know for the purpose of this paper that specific performance is granted under Chinese Law. In China, courts (and the Law) address remedies in terms of the liabilities and obligations of the party in breach and not in terms of the rights of the non-breaching party.[37] Article 18 of FECL states that, only if reasonable remedial measures cannot make up the losses of the non-breaching party, can damages be claimed. In addition to such a consideration, the demands of the State Plan are also taken into consideration.

To sum up: "When a plaintiff insists that the court order the breaching defendant to perform the contract in addition to paying damages for the breach, the court may feel inhibited from seeking a middle ground. Three crucial circumstances are whether the defendant in fact has the ability to perform (otherwise ordering specific performance may be a vain act), whether the performance is available from another source, and whether performance is crucial to the ability of the complaining party to fulfil the state plan. If performance by the defendant provides the only way that the plaintiff can meet the demands of the plan, the judges told us they feel obliged to ensure that the contract serve that plan."[38] In **[page 20]** the past, contracts were broken by order of a higher authority because it will serve the state plan. Whether

such situations change needs to be seen, especially as the new Contract Law has no direct reference to "State interference".

Conclusion

The real problem and difference between interpretations of the CISG between China and Australia stems from the fact that the Chinese legal system, despite enormous advances, still has not reached maturity. Prediction of outcomes is rather difficult, as the interpretation of the black letter law is elastic. It depends on whom or at what level of the hierarchy the interpretation was given. Remember there is no real reliance on interpretations of the courts as we are used to. This point is illustrated in Arbitration Ruling No. 75 [39] where the arbitrator did not attempt to define "reasonable time". He merely indicated that the period in question was beyond what is expected in international trade practice.

Articles 26, 27 and 28 of ECL as an example allow for the modification and termination of contracts. A contract can be modified, if the state plan on which basis a contract was concluded is amended or cancelled.[40] It is not surprising that Chinese firms look for instructions from authorities rather than follow market or legal rules. It is therefore not the CISG, nor any other domestic law, which is the key to success. The right strategy will determine such an outcome. It may sound rather strange, but in order to do business in China a foreigner cannot just think about problems if things go wrong, he also has to think about problems if the venture goes really well.[41] The real conclusion one can take is the fact that the black letter law is a necessary knowledge in order to get things moving. A foreigner needs to understand and work within the "reality" of law. Prudence and patience are important characteristics when doing business in China. Prudence will dictate which black letter laws need to be observed and which ones will be ignored by authorities. The reality of law becomes apparent. If one studies the **[page 21]** language used by high officials in their directives we can describe it as "fluidly political".

In my view, black letter law of China is sufficiently advanced, and the areas of the reality of law are becoming more and more known, so that a foreigner can be confident that his dealings in China can be successful. This optimism is strengthened if we take the new Contract Law into consideration. State plans are not directly mentioned nor do we find direct reference to other interference by the State. What it all means, cannot be said at this point, but we are witnessing another shift of the goal post. This shift appears to favor an interpretation and application of the CISG more in line with the views in other parts of the world.**[page 22]**

FOOTNOTES

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12. Bath / Parnell (note 11) 21.

13. Senger uses the words "Politik und Recht" (Senger, H. v., Die Kodifikationswelle in der Volksrepublik China : Probleme für chinesische und europäische Rechtsanwender, Europa-Institut der Universität des Saarlandes (Saarbrücken 1989), p.4 ff.); English writers seem to prefer policy to politics.

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