

# A PRIMER OF CHINESE CONTRACTS

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We stand for the development of trade with all countries in the world on the basis of equality and mutual benefit. In our time no country can develop its economy in isolation. The more an economy develops, the more foreign trade is needed. This is true of both capitalist and socialist countries.

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## INTRODUCTION

The purpose of this note is to acquaint the reader with People's Republic of China (PRC) standard form contracts and their significance in PRC trade practice. This note is not an exhaustive analysis of PRC contracts, but seeks only to alert the reader to some areas of PRC contract formation that are of continuing interest to those conducting business in the PRC. The basic theme of this comment is that in interpreting PRC contracts practice is more important than contract language and that despite some atypical clauses in PRC contracts, the PRC is most reasonable in its trade dealings.

Since the purge of the "Gang of Four" in October 1976, PRC leadership has stressed the importance of foreign trade, particularly the import of new equipment and technology.<sup>2</sup> In spite of this emphasis on the importance of foreign trade, the PRC does not yet have a substantial body of law governing basic commercial relations and it has not enacted any commercial code.<sup>3</sup> This lack of an established system of commercial law may be a consequence of the low esteem in which the law has traditionally been held in

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1. Quoted in Smith, *Standard Form Contracts in the International Commercial Transactions of the People's Republic of China*, 21 INT'L. COMP. L.Q. 133, 150 (1975).

2. Lubman, *Contracts, Practice and Law in Trade with China: Some Observations*, in CHINESE ECONOMY POST-MAO: A COMPENDIUM OF PAPERS, 764, 766 (1978).

3. Smith, *supra* note 1, at 133; A commercial code is in progress, however, see *China's Laws-They Face a Revolution*, L.A. Times, May 29, 1979, at 1, col. 1.

China as a means for resolving disputes.<sup>4</sup> Lawyers and courts have never held a high position in traditional Chinese society.<sup>5</sup> The adversary system, so familiar to western jurisprudence, did not evolve in Chinese society, where disputes were almost always resolved through mediation and conciliation.<sup>6</sup> Since the time of Confucius, to seek compromise has always been the natural and morally proper thing to do.<sup>7</sup> As a result, this analysis is based upon Chinese practice as well as contract language; there is no case law or commercial code to draw upon.

### A. General

There is no single standard PRC contract. Instead, there are several types of standard form contracts.<sup>8</sup> Of course, if one is in a strong bargaining position vis-a-vis the PRC, one can sometimes negotiate one's own individual contract,<sup>9</sup> but most trade is conducted through the vehicle of standard form contracts.<sup>10</sup> As a generalization, PRC contract terms are less negotiable for buyers than for sellers. Thus, a buyer usually goes to China with significantly less leverage than a seller, unless the buyer is purchasing large amounts.<sup>11</sup>

Usually, PRC purchase contracts are much more detailed than are sales contracts and are worded to bind the foreign supplier very tightly.<sup>12</sup> In contrast, PRC sales contracts are often extremely brief, lacking the boiler-plate of the purchase contracts, and amount to little more than statements of intent.<sup>13</sup> Chinese standard contracts do not usually incorporate internationally recognized terminology as many contracts do when they specifically

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4. Lee & Lai, *The Chinese Conceptions of Law*, 29 HAST. L.J. 1307, 1308 (1978). See generally D. BODDS & C. MORRIS, *LAW IN TRADITIONAL CHINA* (1967).

5. See generally Lee, *Chinese Communist Law: Its Background and Development*, 60 MICH. L. REV. 439 (1962); Cohen & Chiu, 1 *PEOPLE'S CHINA AND INT'L. LAW* 3, 17 (1974).

6. Starr & Kaplan, *The Legal Framework of China Trade*, in *DOING BUSINESS WITH CHINA* 382 (W. Whitson ed. 1974); Lubman, *Mao and Mediation: Politics and Dispute Resolution in Communist China*, 55 CALIF. L. REV. 1284 (1967).

7. HSIAO, *THE FOREIGN TRADE OF CHINA*, 1-7 (1977); See also Starr & Kaplan, supra note 6, at 382.

8. For a collection of PRC contract forms, see National Council for U.S.-China Trade, Special Report No. 13, *Standard Form Contracts of the People's Republic of China* (1975); BUSINESS INTERNATIONAL, *DOING BUSINESS WITH THE PEOPLE'S REPUBLIC OF CHINA*, 97-110 (1974).

9. See Hsiao, *Chinese Trade Contracts* in *LEGAL ASPECTS OF DOING BUSINESS WITH CHINA* 147 (H. Holtzmann ed. 1976).

10. See OVERSEAS ASSIGNMENT DIRECTORY SERVICE, *BUSINESS WITH CHINA* 54 (1979).

11. Lubman, *The Legal Framework of U.S.-China Trade* in *TRADE WITH CHINA* 201, 208 (Boorman and Mugar ed. 1973).

12. Boone, *The Foreign Trade of China*, 11 *CHINA Q.* 169, 175 (1974).

13. *Id.*

refer to International Chamber of Commerce terms.<sup>14</sup> Perhaps most notable is that these contracts are usually not made subject to the law of any nation.<sup>15</sup>

### B. Shipping and Insurance

The PRC prefers to buy goods on an FOB basis, handling all freight charges and insurance. It prefers to sell goods on a CIF or C&F basis, frequently having the foreign importer handle their own insurance. In this way, the PRC preserves foreign exchange, retains the insurance business, and maintains greater freedom of action in handling cargoes.<sup>16</sup>

A significant change over the past few years has been the switch from selling on a pure CIF basis to allowing foreign importers to handle their own insurance. In China, insurance is managed by the People's Insurance Company of China (PICC), which underwrites insurance on transport of imports and exports. In insuring foreign trade, the PRC states, "The People's Insurance Company of China holds that transport insurance on imports and exports should be arranged by the cargo owners." Thus, China's imports are generally insured with the People's Insurance Company of China, whereas insurance on China's exports is generally arranged by the foreign importers. However, the People's Insurance Company of China will also underwrite exports from China if foreign importers so require.<sup>17</sup>

In standard form sales confirmation contracts, therefore, a foreign importer will now find that insurance is simply "to be effected by the Buyers-Sellers" with the "Sellers" usually crossed out. A typical clause used to read: "Insurance: to be effected by Sellers covering all risks and war risks as per The Ocean Marine Cargo clauses of the People's Insurance Company of China, for 110 percent of the invoice value."<sup>18</sup>

When the PRC imports, a typical clause reads: "Insurance: to be covered by the Buyers after shipment." It should be noted that "after shipment" generally means after the goods are "stowed". In other words, in buying FOB, the Chinese buy FOB "stowed", to assure that no title problems arise during the actual loading of the goods.<sup>19</sup>

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14. Lubman, *supra* note 11, at 203.

15. HSIAO, *supra* note 7, at 143; Starr & Kaplan, *supra* note 6, at 381.

16. UNITED STATES DEP'T OF COMMERCE, DOING BUSINESS WITH CHINA 16 (1979). See note 44 *infra* for a discussion of FOB, CIF, etc.

17. *Id.*

18. *Id.*

19. *Id.*

### C. Payment

The standard form contract of a PRC state trading corporation usually requires an irrevocable letter of credit issued through a bank that has a correspondent relationship with the Bank of China.<sup>20</sup> Perhaps in no other area will the seasoned international trader find more departures from customary practice than in the payment context.<sup>21</sup> First, the letter of credit must be confirmed when the PRC is selling but not when it is buying.<sup>22</sup> Second, the letter must be "irrevocable, divisible, assignable, and without recourse" in a PRC sales contract, but it is only "irrevocable" in a PRC purchase contract.<sup>23</sup> Third, the letter must reach the PRC as sellers thirty days before shipment, while in the case of a PRC purchase the letter is to be opened only fifteen to twenty days before shipment.<sup>24</sup> Fourth, a PRC sales contract generally requires "a usual trade margin of 5%, plus or minus, of the quantities confirmed."<sup>25</sup> On the other hand, when buying, the PRC insists that upon full payment, the total amount of the shipment must be delivered.<sup>26</sup> Fifth, when selling, the PRC usually requires the buyers to open a letter of credit payable in the PRC, while when buying, payments will not be made until all of the opening documents have reached the opening banks in the PRC.<sup>27</sup> Sixth, the PRC expressly retains the right to cancel their sales contracts and make a claim for damage against the buyers if the letter of credit fails to reach them before the expiration of the stipulated period. The same right, however, is not expressly granted foreign sellers in the same situation.<sup>28</sup> While the Chinese do sometimes strictly implement these contract provisions to their own advantage, one should not lose sight of the PRC's, and in particular the Bank of China's, well-deserved reputation for financial integrity.<sup>29</sup>

### D. Quality and Inspection

When buying, PRC contract clauses on quality typically state that the seller guarantees that the commodity is made of the best materials, with first-class workmanship, is brand new, and complies in all respects with the quality specifications stipulated in the

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20. See generally Munzel, *Ways of Payment in Foreign Trade*, in *LAW AND POLITICS IN CHINA'S FOREIGN TRADE* 270 *passim* (V. Li ed. 1977).

21. Hsiao, *supra* note 7, at 145.

22. Smith, *supra* note 1, at 141.

23. Hsiao, *supra* note 7, at 145.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. UNITED STATES DEP'T OF COMMERCE, *supra* note 16, at 15.

contract.<sup>30</sup> Typically, however, a PRC sales contract will guarantee only against bad workmanship and faulty materials.<sup>31</sup>

Standard contracts provide that inspections of all goods coming into the PRC are to be conducted by the Chinese Commodity Inspection Bureau<sup>32</sup> and that the certificate issued by the Bureau is final although a reinspection may be requested.<sup>33</sup> For example, one standard form contract provides that within 90 days after the goods arrive at their destination, if the "quality, specifications, or quantity" do not conform to the contract, the buyer shall, on the strength of the inspection certificate issued by the Inspection Bureau, have the right to replace the goods or receive compensation. The same clause further provides that the certificate shall be accepted by the seller as the basis of the claim.<sup>34</sup> This clause gives the Bureau exclusive jurisdiction to determine whether the guarantee has been honored.

Another form of contract provides that the seller shall furnish a certificate of inspection as part of the shipping documents presented to the paying bank and that the goods are to be reinspected by the Bureau. If the goods are not found to be in conformity with the contract after such reinspection, the PRC may reject the goods or file a claim.<sup>35</sup>

According to one commentator,

In the China trade, the seller must be particularly careful, not only because the Chinese often insist on the highest standards of performance of Western products, and try to hold the seller to the exact letter of the specifications and assurances, but because they also insist on the finality of their tests of the product after delivery and installation. Moreover, they do not easily compromise their claims in respect to such matters.<sup>36</sup>

Fortunately, "[I]n practice the Chinese seem to exercise the right to inspect before payment only rarely, but they do protect themselves by putting in the clause."<sup>37</sup>

The meticulousness of PRC inspections is well known in the international business community. For example, while most buyers test steel pipe by random X-rays, the PRC inspectors test every inch, and complain about hairline cracks which other purchasers

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30. Smith, *supra* note 1, at 147.

31. *Id.* at 151; HSIAO, *supra* note 7, at 151.

32. The Chinese Commodity Inspection Bureau (CCIB), a bureau immediately under the Ministry of Foreign Trade in the PRC trade structure, performs final inspection of all import and export goods on behalf of PRC Foreign Trade Corporations (FTCs). See HSIAO, *supra* note 7, at 150.

33. Lubman, *supra* note 11, at 205.

34. HSIAO, *supra* note 7, at 150.

35. *Id.*

36. Lubman, *supra* note 11, at 204.

37. *Id.* at 206.

would ignore. In addition, when sellers of piston rings describe the quantity by volume, the PRC has been reported to count each individual piston ring one by one and then write a letter indicating that the shipment was short by so many piston rings, or there were so many extra ones.<sup>38</sup> In spite of the unusual rigorousness of the Chinese inspections, serious claims are infrequent.<sup>39</sup>

### E. Delivery

According to one observer, this is one area where the PRC does like to see a lot of boiler-plate.<sup>40</sup> When buying, the PRC often tries to negotiate rather stiff penalties for late delivery, usually on an escalating schedule.<sup>41</sup> This incentive for prompt delivery is presumably a reflection of the disastrous effects of late delivery in a "command economy".<sup>42</sup> Notwithstanding these penalty clauses, some PRC Foreign Trade Corporations have waived penalty payments when they believe the cause was beyond the sellers' control.<sup>43</sup>

Concerning the delivery of goods, the preferred procedure is FOB the vessel,<sup>44</sup> with inland freight to be born by the seller, and sufficient notification to the Chinese to allow them to reserve space on their own vessels.<sup>45</sup> The reason the PRC insists on this procedure is to preserve scarce foreign exchange by self-insuring and using China's own vessels.<sup>46</sup>

### F. Force Majeure

In general, any reference to strikes and acts of God is unac-

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38. *Id.*

39. *Id.*

40. Interview with John M. Isaacs, President, I.B.D. Trading, Inc., in Los Angeles (Sept. 15, 1981).

41. *Id.*

42. See Goldman, *The Soviet Economy Is Not Immune*, 21 FOREIGN POLICY 76-85 (1976).

43. UNITED STATES DEP'T. OF COMMERCE, *supra* note 16, at 14.

44. Under FOB terms, seller assumes-all risks until delivery of the goods on board a vessel, pays export duties and is liable for obtaining export licenses. Under CIF terms seller: (1) charters a vessel or freight space in the vessel, (2) pays the freight fare to the port of destination, (3) insures the goods up to the amount agreed upon in the contract, (4) is liable for obtaining export licenses and giving assistance to the buyer in obtaining related documents requested by the exporting country, and (5) provide the buyer with a clean bill of lading, insurance policies, invoices and all documents stipulated in the contract. The buyer must pay all expenses specified in the contract, and unload the goods at destination. All risk passes to the buyer once the goods are loaded on board the vessel in the port of shipment. Lebedoff, *The People's Republic of China's Purchase Contracts with the Soviet Union and Nonsocialist Countries*, 28 AM. J. COMP. LAW 644, 649 (1979); See also U.C.C. § 2-319 through U.C.C. § 2-325.

45. Isaacs, *supra* note 40.

46. UNITED STATES DEP'T. OF COMMERCE, *supra* note 16, at 21.

ceptable to the PRC.<sup>47</sup> With respect to force majeure clauses, standard form contract language is usually vague and often refers to "circumstances which both parties agree to be beyond the control of either party".<sup>48</sup> Notification procedures and time periods also are defined in the clause. In practice, the PRC will often acknowledge strikes against a third party which affect a foreign seller's ability to perform.<sup>49</sup> An example of this is a shipping strike that delays delivery or a strike by a sub-contractor over which the general contractor has no control.<sup>50</sup> However, the PRC might not recognize a strike directly against a primary supplier as force majeure. The Chinese might feel that suppliers have sufficient control over such situations, and view it as the primary supplier's responsibility to negotiate a contract with employees so as to prevent a strike.<sup>51</sup>

When exporting, the PRC usually insists on provisions that could justify late or non-delivery due to either force majeure or the buyer's failure to forward the letter of credit to the PRC in time for shipment.<sup>52</sup> When selling, PRC contracts do not provide for specific penalties for late or non-delivery other than the right to cancel the contract.<sup>53</sup> PRC purchase contracts, on the other hand, with the exception of the force majeure clause, generally stipulate a penalty of no more than five per cent of the value of the goods involved in the later delivery.<sup>54</sup>

Although the PRC relies on and accepts force majeure as a justifiable cause for late delivery or non-delivery in both sales and purchase contracts, in most instances what constitutes force majeure is not defined.<sup>55</sup> It is interesting to note that while the PRC does not include strikes and labor disputes within the scope of force majeure,<sup>56</sup> since 1975 the PRC Constitution provides all

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47. See generally Hsiao, *Chinese Trade Contracts*, in *LEGAL ASPECTS OF DOING BUSINESS WITH CHINA* 170-177 (H. Holtzmann 1976).

48. *Id.*

49. Isaacs, *supra* note 40.

50. *Id.*

51. Hsiao, *supra* note 47, at 175.

52. HSIAO, *supra* note 5, at 151.

53. *Id.*

54. Starr & Kaplan, *supra* note 6, at 385.

55. Although standard form contracts vaguely define force majeure, the Chinese trade manual, *FOREIGN TRADE PRACTICE*, gives the following definition: "In general force majeure includes two categories of factors: (1) Natural factors, e.g. earthquake, typhoon (or hurricane), lightning, colossal floods and drought, epidemics, contagious disease and any other that cannot be prevented or predicted by humans, or controlled by any reasonable measures. (2) Manmade Factors, such as those caused by circumstances which influence time of delivery". Translated in *China Bus. Rev.*, 26-27, Nov.-Dec. 1975.

56. Shea, *China's Joint Venture Law: First of the Economic Laws*, 4 *A.S.I.L.S. Int'l L.J.* 61 (1980).

Chinese citizens with the "freedom to strike".<sup>57</sup> It is still unclear whether this new development will affect foreign trade policy and practice.<sup>58</sup>

At one time a clause found in a purchase contract of the China National Machinery Import and Export Corporation (MACHIMEX)<sup>59</sup> seemed to obligate the seller to deliver the goods in spite of any force majeure incident. Even if the force majeure was beyond human control, it appeared that the sellers could still be liable for non-delivery. In practice, what this has meant in the past is that if the object of the contract is vital to the development of PRC industry, the PRC would require the sellers to make every effort to make the deal work despite the force majeure circumstances.<sup>60</sup>

Whether the PRC insists on the payment of any penalty depends on a number of factors. These factors include how detailed an explanation the seller gives the Chinese as to the reason for the delay, how badly the Chinese need the object of the contract, and perhaps most important of all, how sincere the Chinese think the seller is. Not surprisingly, the past relationship of the parties also is of paramount importance. The Chinese estimation of the other party's sincerity has a considerable impact on the relationship between the parties. In some cases, where a prior relationship existed, the Chinese have been quite understanding about delays and have refrained from demanding penalties, despite language to the contrary in the contract.<sup>61</sup>

### G. Settlement of Disputes

Perhaps no other area of PRC trade practice is of more interest to the foreign businessman than how PRC contract disputes will be settled. This is an area of increasing change, as foreign suppliers and buyers pressure the PRC into bringing its trade practices in conformity with the rest of the world. Contract disputes impede the orderly flow of international trade if they are not promptly resolved in accordance with the interests of both parties.<sup>62</sup> Traditionally, the Chinese found the settlement of a monetary matter before a magistrate humiliating and considered

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57. CHINA CONST. art. 23; Whitson, *supra* note 6, at 385; Hsiao, *supra* note 7, at 153.

58. Shea, *supra* note 56, at 61.

59. The China National Machinery Import and Export Corporation is one of the PRC's major Foreign Trade Corporations under the Ministry of Trade. See HSIAO, *supra* note 7, at 153.

60. Lubman, *supra* note 2, at 775.

61. Lubman, *supra* note 11, at 203-204.

62. Gardner, *Economic and Political Implications of International Commercial Arbitration* in INTERNATIONAL TRADE ARBITRATION 15, 16 (Domke ed. 1958).

lawyers who encouraged court litigation small-minded and undeserving of community respect.<sup>63</sup> While legal avenues were always open for the adjudication of disputes, conciliation and mediation were the preferred methods.<sup>64</sup>

In general, the Chinese do not like to litigate disputes in a court of law. This is understandable in light of tradition and the absence of a PRC commercial code. Similarly, there is a reluctance to consent to a hearing in a foreign court of law. This again is understandable in view of China's past experiences with foreign powers.

The PRC prefers to settle disputes by friendly negotiations and utilizes arbitration only as a last resort.<sup>65</sup> PRC contracts, in general, do not spell out formal procedures for the settlement of disputes but do often allude to unspecified processes by which an amicable settlement may be obtained.<sup>66</sup>

In the more common PRC contracts that do not provide for arbitration, there are three avenues for the settlement of disputes.<sup>67</sup> The first, settlement through friendly negotiations, has the parties engage in direct negotiations without involving an official PRC organization.<sup>68</sup> In the second avenue, third party conciliation, the dispute is brought to the attention of the Foreign Trade Arbitration Commission (FTAC),<sup>69</sup> the Maritime Arbitration Commission (MAC),<sup>70</sup> or the Arbitration Committee of the Legal Affairs Department of the Ministry of Foreign Trade's China Council for the Promotion of International Trade (CCPIT).<sup>71</sup> These institutions will not recommend a solution but will assist the parties in finding a solution between themselves.<sup>72</sup> Under the third avenue, the arbitration body will act as a conciliator at the request of either party and make suggestions on how to resolve the dispute.<sup>73</sup> These suggestions, however, are not binding on the parties.<sup>74</sup> Under any of the above avenues, the settlement negotiations can be carried out either face to face or through

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63. HSIAO, *supra* note 7, at 154.

64. Starr & Kaplan, *supra* note 6, at 382-85.

65. Shea, *supra* note 56, at 59.

66. Starr & Kaplan, *supra* note 6, at 385.

67. Smith, *supra* note 1, at 139.

68. Holtzmann, *Resolving Disputes in U.S.-China Trade* in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 77, 81 (Holtzmann ed. 1976).

69. The Foreign Trade Arbitration Commission and its counterpart the Maritime Arbitration Commission are administered by the China Council for the Promotion of International Trade (CCPIT). See Reghizzi, *Trade with Italy* in LAW AND POLITICS IN CHINA'S FOREIGN TRADE 183 (V. Li ed. 1977).

70. *Id.*

71. *Id.*

72. HSIAO, *supra* note 7, at 155 *passim*.

73. *Id.*

74. *Id.*

correspondence.<sup>75</sup>

Despite the fact that some standard form PRC contracts provide for the resolution of disputes through arbitration, arbitration is only a last resort that is used when the avenues listed above have not provided a solution.<sup>76</sup> In the past few years there have been very few reported cases of arbitration.<sup>77</sup> For example, in the case of trade between China and Japan, there have been few reported cases of arbitration in the last twenty years.<sup>78</sup> In these cases arbitrators in the PRC brought strong pressure on the parties to reach an amicable settlement.<sup>79</sup> While Beijing (Peking) is usually stipulated to be the site of arbitration,<sup>80</sup> there is a trend to hold formal arbitration in Stockholm, following the rules of arbitration of the Stockholm Chamber of Commerce.<sup>81</sup> For example, a contract between the PRC and the Radio Corporation of America (RCA) provided for arbitration in Stockholm.<sup>82</sup> The procedure for the selection of the arbitration board is negotiable,<sup>83</sup> with one standard procedure being the nomination of one member by each of the two parties, after which the two arbitors select the third member as chairperson.<sup>84</sup> In sum, the PRC still seeks to avoid arbitration, preferring instead friendly negotiations. For example, during all of 1974 only one dispute was resolved through arbitration, twelve by mediation, and more than 100 by friendly negotiations.<sup>85</sup>

The Trade Agreement between the United States and the PRC of July 7, 1979<sup>86</sup> provides for the settlement of disputes. Articles VII and VIII provide for the means of settlement of "problems" and "disputes" arising in the course of trade relations.<sup>87</sup> Article VII provides that in the event of trade problems between the two governments, "friendly consultation" shall be held promptly to discuss and remedy the situation.<sup>88</sup> This provi-

75. *Id.*

76. Mitchell, *Dispute Settlement in China*, 4 A.S.I.L.S. 71, 88 (1980).

77. Torbert, *The American Lawyer's Role in Trade with China*, 63 A.B.A.J. 1117, 1119 (1977).

78. Henderson & Matsuo, *Trade with Japan in Law and Politics in China's Foreign Trade* 54 *passim* (V. Li ed. 1977).

79. Starr & Kaplan, *supra* note 6, at 385; Lubman, *supra* note 11, at 210.

80. *Id.* at 209.

81. OVERSEAS ASSIGNMENT DIRECTORY SERVICE, *supra* note 10, at 54.

82. Hawkins, *RCA's Venture in China* in TRADE WITH CHINA 224 (Boarman and Mugar ed. 1973).

83. Holtzmann, *supra* note 68, at 113.

84. Lubman, *supra* note 2, at 778.

85. Torbert, *supra* note 77, at 1119.

86. Trade Agreement, July 7, 1979, United States-People's Republic of China, reprinted in 18 INT'L. LEGAL MATS 1041 (1979) [hereinafter Trade Agreement].

87. Comment, *International Trade*, 20 HARV. INT'L L.J. 708, 711 (1979).

88. Trade Agreement art. 7, sec. 1.

sion is almost identical with the resolution of dispute clause included in the 1978 Trade Agreement between the PRC and the European Economic Community.<sup>89</sup> Unfortunately, neither agreement gives a clear definition of what "friendly consultations" means. According to one observer, these friendly consultations would seem to include some form of binding arbitration between the two governments, since the next section of the Trade Agreement allows unilateral action by either country if such consultations do not provide mutual satisfaction.<sup>90</sup>

The provisions for arbitration of contract disputes between private parties are considerably more specific than those that apply to governments.<sup>91</sup> Article VIII states that each government shall promote "friendly consultations" between private parties in the case of a disagreement.<sup>92</sup> If these friendly consultations do not resolve the problem, the dispute is to be resolved by arbitration "in accordance with provisions specified in their (private parties') contracts or other agreements to submit to arbitration".<sup>93</sup> This arbitration may be conducted before any "arbitration institution" of any country.<sup>94</sup> One observer views the foregoing as meaning that contract disputes will be subject to the authority of either country, if the parties so agree, or the appropriate trade boards of the United States and the PRC.<sup>95</sup> Article VIII Section 2 provides that the procedures and other rules of the forum arbitrating the dispute will apply, but that the arbitration rules of the United Nations Commission of International Trade Law, or any other set of rules, may be applied if the parties so agree.<sup>96</sup>

Article VIII does not make any provision for the settlement of disputes where the parties have not included a prior agreement on some form of arbitration. The presence of a clause regarding arbitration, while neither specific nor comprehensive, is a considerable improvement over previous PRC trade agreements. For example, EEC-PRC and Japan-PRC Trade Agreements do not contain a clause on arbitration beyond non-specific generalities on "consultations",<sup>97</sup> and only a few of the trade agreements negoti-

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89. Comment, *supra* note 87, at 711. See also 19 HARV. INT'L. L.J. 1048 (1978).

90. Trade Agreement, art. 7, sec. 2 is ambiguous: "[I]f consultations do not result in a mutually satisfactory solution within a reasonable period of time, either Contracting Party may take such measures as it deems appropriate."; According to Comment *supra* note 87, at 711 n.22, "Presumably, such action would refer to unilateral abrogation of an agreement, or closing of a trade office . . .".

91. Trade Agreement art. 8, sec. 1.

92. *Id.*

93. Trade Agreement art. 8, sec. 2.

94. *Id.*

95. Comment, *supra* note 87, at 711.

96. Trade Agreement art. 8, sec. 2.

97. See 19 HARV. INT'L. L.J. 1048 (1978).

ated by the PRC in recent years contained any arbitration clause at all.<sup>98</sup>

As far as actual compensation for claims settled, the PRC frequently considers that a settlement has been made when a buyer makes further purchases from the PRC. The Chinese seem to prefer not to give monetary damages for claims. They prefer to give some concessions on subsequent transactions as, for example, giving a discount on the next purchase. On occasion the PRC has agreed to design, package, or label a product according to a buyer's specifications. In one reported case, an Austrian importer of ski gloves received his shipment too late for the winter selling season through the fault of a PRC Foreign Trade Corporation. The Chinese, although they were not willing to give him cash compensation, were willing to copy an Austrian ski glove to his exact specifications, something that they were previously unwilling to do for this buyer.<sup>99</sup> As mentioned above, in the settlement of claims, much depends on the relationship between the parties, particularly the degree to which the Chinese believe the other side to be "sincere".<sup>100</sup>

Recent trends indicate that Chinese legal experts are placing increasing emphasis on developing a theory or philosophy of arbitration as an alternative to litigation.<sup>101</sup> In particular the PRC is taking a very active part in the U.N. Commission on International Trade Law.<sup>102</sup> In trade dealings between countries with different traditions and economic and administrative systems, the prospect of an objective solution to disputes is the key to mutual trust and the continued growth of trade.<sup>103</sup>

## CONCLUSION

It is not surprising that in the absence of a comprehensive legal system, much less a commercial code, actual PRC trade practice is more important than specific contract language.<sup>104</sup> Although the PRC seeks maximum protection in their standard form contracts, when performance is due they are often much more conciliatory than these contract provisions would indicate.<sup>105</sup> In the PRC, as in traditional China and throughout Asia, much de-

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98. Chiu, *THE PEOPLE'S REPUBLIC OF CHINA AND THE LAW OF TREATIES*, 80 n.3 (1972).

99. Lubman, *supra* note 11, at 210, 211.

100. *Id.* at 211.

101. Isaacs, *supra* note 40.

102. *Id.*

103. Mitchell, *supra* note 76, at 88.

104. Lubman, *supra* note 11, at 209, 211-12.

105. Starr & Kaplan, *supra* note 6, at 386; UNITED STATES DEP'T. OF COMMERCE, *supra* note 16, at 14.

depends on the relationship between the parties. Business relationships and personal relationships are interdependent.<sup>106</sup> Between friends, all things are possible. On the whole, the PRC has an excellent reputation for living up to its contract obligations.<sup>107</sup> The PRC wants to avoid any settlement that resembles litigation or adjudication and will go to great lengths to smooth over differences, especially where a prior relationship exists.

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106. Mitchell, *supra* note 76, at 89; See also Clever, *Coping with Politics and People in the China Trade: The Canadian Experience*, in TRADE WITH CHINA 161 (Boarman & Mugar ed. 1973).

107. UNITED STATES DEP'T. OF COMMERCE, *supra* note 16, at 13 *passim*; Buxbaum, *Negotiating with the Chinese*, in TRADE WITH CHINA 156 (Boarman & Mugar ed. 1973).