DRAFTING THE UNIFORM CONTRACT LAW IN CHINA*

PING JIANG**

The conceptual foundation of the Uniform Contract Law ("UCL") in China is different from that of the Uniform Contract Code ("UCC") in the United States. The UCL is a substitute for the three contract laws governing different types of transactions. In contrast, the UCC is a model for the contract law of individual states. The official name of the UCL is the "Contract Law of the People's Republic of China." Here, I use the name UCL to distinguish it from the existing contract laws in China.

The preparatory work of the UCL began in 1993. Its drafting process consists of three stages:

> (1) Legal scholars and experts from fourteen renowned law schools engage in extensive discussions. They formulate the law based on a designated structure and submit the first draft to the Judicial Committee of the National People's Congress;
> (2) State ministries and bureaus concerned submit their opinions to the Judicial Committee. The Judicial Committee revises the law accordingly and distributes the second draft to officials and institutions across the country;
> (3) The Judicial Committee solicits opinions from local governments, regional bureaus, courts, law schools, and legal research institutes. It conducts a national hearing and produces the final draft.

Now, the drafting of the UCL is in the second stage. The Judicial Committee expects that the third stage will commence in late 1996. The objective is to present the UCL for enactment at the Fifth Meeting of the National People's Congress ("NPC"), which will take place in March 1997.

---

* Lecture, March 1996, delivered at the Center for Chinese Legal Studies, Columbia Law School. Translated from Chinese by the Columbia Journal of Asian Law.

** Professor of Law, China University of Political Science & Law. Visiting Professor of Law, the Center for Chinese Legal Studies, Columbia Law School.

The UCL is not a product of mechanical restructuring or reform of the existing contract laws. The drafters have paid special attention to the framework and contents of the law based on four underlying principles: uniformity, freedom of contract, creditors' interests, and functionalism. I will discuss each of these principles in detail.

I. UNIFORMITY

China's market economic policy is the driving force behind the drafting of the UCL. A contract law that is applicable to all areas will better serve the homogeneous market prescribed by the policy. At present, contracts in China are governed by four laws. The General Principles of Civil Law promulgates the basic principles in contract law, while the Economic Contract Law, the Foreign Economic Contract Law, and the Technology Contract Law set forth the substantive standards.[1] These three contract laws are distinct from each other.

A. The Unity of Domestic and Foreign Laws

The Economic Contract Law, the product of a planned economy, governs domestic economic relations. Parties do not have much flexibility under the Economic Contract Law because its provisions are mandatory. In contrast, the Foreign Contract Law embodies freedom of contract. The market economy in China today no longer justifies the artificial distinctions between the two laws. These distinctions also undermine China's efforts to join the World Trade Organization ("WTO"). To participate in free trade, China must promulgate contract laws that are consistent with the standards of the international community.

---

1. Zhonghua Renmin Gongheguo Mingfa Tonze [General Principles of Civil Law of the P.R.C.] [hereinafter General Rules of Civil Law]; Zhonghua Renmin Gongheguo Jingji He Tongfa [Economic Contract Law of the P.R.C.] [hereinafter Economic Contract Law]; Zhonghua Renmin Gongeheguo Shewai Jingji He Tongfa [Foreign Economic Contract Law of the P.R.C.] [hereinafter Foreign Economic Contract Law]; Zhonghua Renmin Gongheguo Jishu He Tongfa [Technology Contract Law of the P.R.C.] [hereinafter Technology Contract Law]. Each of the Contract Laws can be found in volume 1 of CHINA LAWS FOR FOREIGN BUSINESS (Stephen Fitzgerald ed. 1993); the General Rules of Civil Law are in volume 3.

B. *The Unity of National and Local Laws*

Unlike the United States, where states have the power to promulgate their own contract law under a federal system, power resides in the central government of China. The legislative power of the NPC is, however, not exclusive: regional and local governmental authorities also have legislative power. Accordingly, conflicts between national and local legislation are not impossible. For example, such conflicts became prominent when the central government enacted its regulations against usury in 1986. As regional differences in economic development require private loans at sharply different rates, the central government found it difficult to fix a national standard for "usury." Meanwhile, the central government could not delegate its power to local authorities as a matter of principle: in China, with the exceptions of laws in Hong Kong and Macau after 1997, domestic laws may not conflict with each other. In other words, local governments may not modify the Uniform Contract Law after its promulgation, and they may not promulgate their own contract law either.

C. *The Unity of Civil and Economic Laws*

Two categories of contracts exist in China: civil contracts and economic contracts. The two categories differ in four major aspects. First, state planning affects substantive rights stipulated in economic contracts but not those stipulated in civil contracts. Second, parties to a civil contract are natural individuals, while parties to an economic contract are legal persons. Third, civil divisions of the general courts may hear disputes arising from civil contracts, while economic divisions of the general courts have the jurisdiction to hear disputes arising from economic contracts. Fourth, civil contracts and economic contracts require the use of different legal terms. Under the paradigm of economic contracts, for example, a buying-and-selling agreement is a marketing contract; a private loan agreement is a bank credit contract; a storage agreement is a warehouse contract. The Uniform Contract Law would eliminate these artificial distinctions and enhance the uniformity in contractual relationships.

D. *The Unity of Parties and Subject Matter*

Both the Foreign Economic Contract Law and the Economic Contract Law define their scope of coverage according to the status of contractual parties. The former is applicable to "economic contracts between a

domestic enterprise or economic organization and a foreign enterprise, economic organization, or individual." The latter are applicable to "economic contracts between two domestic legal persons, between two domestic economic organizations, or between a domestic legal person and a domestic economic organization." In contrast to the Foreign Economic Contract Law and the Economic Contract Law, the Technology Contract Law defines its scope of coverage according to the subject matter of contracts. The Technology Contract Law is applicable to "contracts related to technological developments, licensing, consulting, and provisions of services between two legal persons, two individuals, or a legal person and an individual." The inconsistencies among the three contract laws reflect the current confusion in this area. If the legal principle differs according to the identities of parties or the subject matter of a contract, we would end up having many contract laws. The Uniform Contract Law seeks to address the confusion by eliminating the distinctions.

II. THE FREEDOM OF CONTRACT

The principle of freedom of contract is essential to a market economy and international trade. To promote free trade and foreign investment, China's legal system must recognize and protect the right to freedom of contract. Accordingly, the drafting of the Uniform Contract Law has taken into account the following issues.

A. Elective Provisions

The provisions of the Economic Contract Law are mandatory, and parties therefore do not have much flexibility in drafting their agreements. This is because the Economic Contract Law was a product of a planned economy. The notion of elective provisions first appeared in 1992, when the government adopted the Maritime Law.[2] Under the "General Rules" section of chapter six, "the Leasing Contracts of Ships and Vessels," the Maritime Law stipulates that "the regulations governing the rights and duties of lessor and lessee apply only to contracts of ships and vessels that contain no or conflicting provisions on such issues." The provisions governing damages for breach of a contract stipulated in the Economic

2. Zhonghua Renmin Gongheguo Haishang Fa [Maritime Law of the P.R.C.] [hereinafter Maritime Law] in China Law for Foreign Business, *supra* note 1.

Contract Law and the Foreign Economic Contract Law clearly exemplify the differences between a mandatory provision and an elective provision. Under the Economic Contract Law, parties may not stipulate the damages resulting from a breach of contract. In contrast, under the Foreign Economic Contract Law, parties may include contractual provisions governing damages that arise from a breach of contract. The Uniform Contract Law will follow the principle set forth in the Foreign Economic Contract Law. In other words, the standards set forth by the law only apply when the contract contains no provisions governing the same issue.

B. Offer and Acceptance

The existing contract laws in China have one major flaw: the lack of provisions on offer and acceptance. Accordingly, parties may only contract through formal procedures: they must make their agreement in writing, stamp and sign the agreement properly, and obtain the necessary governmental approval. These unduly formalistic requirements are vestiges of China's planned economy.

The Uniform Contract Law will contain provisions on offer and acceptance. Under the new provisions, a contract is formed when an offer is effectively accepted. Nevertheless, during negotiations, the parties have the right to stipulate their own rules before they make an offer or acceptance, such as requiring a duly-signed confirmation document.

The General Principles of Civil Law and the three existing contract laws do not impose liability on parties who breach their duties during negotiations. In practice, parties often provide in their agreements that they will sign a contract in the future. Under the current framework, these agreements are not legally binding because no contract has been established. To overcome this defect, the Uniform Contract Law will provide that, with the payment of a deposit, the parties may protect their legal rights through "an agreement that reserves the right to make a contract within a specific period."

C. Void and Voidable Contracts

The Economic Contract Law used to contain no provisions on voidable contracts: contracts in China were either valid or void. The lack of recognition of voidable contracts reflects the limitations on freedom of contract under a planned economy. The current version of the Economic Contract Law permits limited use of voidable contracts when a contract is

"unconscionable" or involves "material misunderstanding" between the parties. But courts still too often find that contracts are void rather than voidable. Courts often declare a contract invalid when the parties are contracting outside their line of business, when certain clauses or provisions are missing, or when the contract conflicts with certain laws or regulations. Contracts entered by fraud or duress are voidable in most countries, but these contracts are void per se in China. This blatant rule often has extensive legal consequences, as the parties may not ratify a void contract easily. The Uniform Contract Law will bring China in line with most countries: the definition of void contracts in the law will be more restrictive in scope.

D. Statutory and Contractual Remedies

Under the existing contract laws, parties may not disclaim their liabilities through contractual provisions. For example, the Economic Contract Law expressly prescribes the legal liabilities for a breach of contract, and the contracting parties may not alter such liabilities. The principle of freedom of contract requires giving parties the right to disclaim their liabilities up to a certain level. To comply with this principle, the Uniform Contract Law will give contracting parties the right to disclaim their liabilities except in the following circumstances: (1) the breach of contract is intentional or arises from a serious fault; (2) personal injuries are involved; (3) statutory prohibitions exist. This is a balance between the principle underlying the mandatory provisions and that underlying the elective provisions.

III. CREDITORS' INTERESTS

For contractual disputes that involve litigation, the most urgent problem is to provide the proper means to protect the interests of creditors adequately. The intertwining of debts among different enterprises has created an obscure phenomenon: debtors believe that they have the right to withhold payments. Accordingly, a creditor is often willing to incur huge banquet expenses with the expectation that the debtor would eventually make the payments. Although the creditor has the right to take its case to courts, the right offers limited protection as the percentage of default judgments is astounding. The lack of protection for creditors' rights is a disturbing issue in today's market economy, and the issue could be attributed partly to the flaws inherent in the existing contract laws and

partly to the lack of effective enforcement mechanisms. The principles behind the enactment of the Uniform Contract Law suggest that creditors' rights are an important concern in the legislative process.

A. Right to Unilateral Termination

The Economic Contract Law was a product of the planned economy. Under the law, a contract must be fully enforced: a party may not terminate a contract unilaterally because the other party has not fulfilled its contractual obligations. Accordingly, creditors are at a disadvantageous position, especially when contractual frauds and siphoning of profits are common. Creditors must have the right to suspend their contractual obligations temporarily. Under the Uniform Contract Law, a creditor has the right to do so if the debtor: 1) is unable to fulfill its obligations; 2) evades its obligations through transfers of properties or withdrawals of investment capital; 3) engages in fraudulent conduct on third parties; 4) experiences serious financial difficulties, which could result in a loss of its ability to fulfill the obligations; 5) undergoes mergers, spinoffs, or relocations without proper notifications.

B. Preservation of Debt

For centuries, civil law countries have relied upon the Roman law system of "the preservation of debt" as an effective means for protecting the creditor's interests. Not only is this system different from a debt guarantee, it is also different from the preservation of litigation rights. The Uniform Contract Law contemplates the adoption of the Roman law system. This system involves two relevant aspects.

The first aspect concerns the right of succession. If a debtor fails to take the initiative in exercising his rights as a creditor vis-a-vis a third party and thereby seriously impairs the original creditor's materialized interests, the creditor can exercise such rights for his own behalf against the third party. However, this right of succession is not applicable in situations where the creditor's interests are mandated by law or are by their nature in conflict with the power of succession. Under the existing law of China, the right of succession is available only to creditors who are jointly and severally liable, guarantors, note-holders, and insurers. The creditor may not directly exercise his debtor's right through the right of succession. As a result, debtors frequently hide or transfer their property which should be used to meet their debt obligations. Some debtors even refuse to claim their

property right because any benefit received therefrom would be passed onto their creditors. This is one of the reasons for the existence of multilateral debt (also known as "triangular debt") that is pervasive among industries in China. It is therefore necessary to provide creditors the right of succession in the draft version.

The second aspect concerns the right of renunciation. If serious impairment of the creditors' interests occurs as a result of a debtor's forgiving of his claim on third parties or otherwise disposing his claim without adequate consideration, the creditor may request a renunciation of such actions. Presently, under Chinese law, there is only one type of right of renunciation, which is restricted to bargains involving material misunderstandings or unconscionable terms. Elsewhere in the world, standard bankruptcy law provides for the creditor's right of renunciation if the debtor forgives his claim or otherwise disposes his claim without adequate consideration for a certain period of time prior to the declaration of bankruptcy. In drafting the new Bankruptcy Law, actions that are void under the existing Bankruptcy Law of China will be converted to the right of renunciation. It is essential to provide this kind of protection to creditors.

C. Right to Recission

The right to rescind a contract unilaterally is a natural and necessary component of a market economy. The provisions regarding this matter are different under the existing Economic Contract Law and the Foreign Economic Contract Law. Under the Economic Contract Law, the reasons given for the unilateral rescission of contract are largely related to the normal operations of a planned economy, such as "changes in or elimination of a state project that is referred to in an economic contract"; or when "a party involved fails to fulfill his economic contractual obligations due to liquidation, closing, or shifting of property interests." Unilateral rescission of contract on the grounds that the other party has breached the contract, however, is provided for only vaguely: when "implementation of an economic contract becomes unnecessary because one party has breached the contract." This type of provision often gives rise to further disputes over the definition of "unnecessary." In contrast, provisions in the Foreign Economic Contract Law reflect the legal principle of a market economy. Unilateral rescission of contract is allowed when the "other party has breached the contract, resulting in a serious impairment on the anticipated economic benefits measured at the time of

the signing of the contract" or when "the other party fails to fulfill his contractual obligations within the time period stipulated by the contract, and fails to cure within the authorized deferral period." The Uniform Contract Law will be written in a manner consistent with the Foreign Uniform Contract Law. In actuality, instead of deferring the fulfillment of his debt obligations, a debtor often refuses to fulfill his obligations completely. Thus, the draft version has included a new reason for rescission: when "the other party indicates that he would refuse to fulfill all of his debt obligations or a majority of his debt obligations, and refuses to fulfill such obligations despite subsequent warnings." In all the above-stated situations, the party injured may unilaterally rescind the contract. The right to unilaterally rescind a contract is an effective means for the protection of a creditor's interests. However, the duration during which this right may be exercised should be carefully limited by statute, since it might otherwise infringe upon the interests of the other party.

D. Consequential Damages

The scope of compensatory damages provided for breach of contractual obligations has been a source of constant debate for many years. The General Principles of Civil Law provides that the "duty of compensation that arises from the unilateral rescission of contract should be equal to the damages suffered by the other party." The Foreign Economic Contract Law includes an additional requirement: "but it must not exceed the anticipated losses foreseeable by the party in breach of the contract, which is measured at the time of the signing of the contract." According to the legal explanations that were offered by the People's Supreme Court during its interpretation of the Foreign Economic Contract Law, damages arising from the breach of contract should "include the destruction, diminution in value, and loss of the property, and the expenses used in reducing or eliminating the losses of such, as well as the interests that would have been generated if the contract were implemented (which means profits under an international trade contract)." Accordingly, "expected profit" is also included in the scope of damages arising from the breach of contract. Nevertheless, under the Economic Contract Law no such provisions or interpretations have been made. In practice, no "expected profits" are ever compensated in domestic disputes. This is because the amount of money involved is potentially so large that a state-owned enterprise can hardly be expected to be responsible for it. This double standard can no longer exist after the unification of the contract

laws. Obviously, the standard of the Foreign Economic Contract Law will be followed. This will be beneficial for creditors' interests because it increases the protection available.

E. Parties Acting in Good Faith

The Uniform Contract Law should not merely increase the protections available to a creditor, it should also strengthen the rights of a party who acts in good faith. This issue has not been directly addressed in the Uniform Contract Law. For example, suppose A sells B's property to C, when A does not in fact have the executory power over B's property rights. If C is acting in good faith, that is, he does not know and has no reason to know that A does not have the corresponding property right or executory power in such property, should his contractual right be legally protected? Because there are no explicit legal provisions on this issue, and the rules in practice conflict with each other, in many instances, the good faith party's interests are not adequately protected subsequent to the voiding of the contract. The Uniform Contract Law explicitly states, "When a party who executes other people's property rights fails to obtain the executory power in advance, or to receive a subsequent ratification by the executor, or to obtain the executory power afterwards, the contract signed by him will be void. If the adverse party is acting in good faith and has reason to believe that the other party to the contract has the executory power, his contractual right as provided in that contract will be legally protected."

IV. FUNCTIONALISM

The fact that China's laws are generalized, difficult to operate, and subject to considerable arbitrariness are some of the reasons for the various improvements noted and requested by a number of legal scholars inside and outside China. Of the 156 clauses in the Civil Law of 1986, only 10 clauses concern contracts. The Economic Contract Law of 1981 has only 57 clauses, and the Foreign Economic Contract Law of 1985 has only 43 clauses concerning contracts. The situation has changed noticeably with the promulgation of laws enacted within the past few years, such as the Maritime Law passed in 1992, which has 278 clauses. Not surprisingly, the debate over how detailed the UCL should be drafted has been alive throughout the legislative process. Generally speaking, contract law should adhere to the principles of practicability and functionalism, which consist of the following aspects.

A. *The UCL and the General Principles of Civil Code*

The first concern is with the status of contract law within our legal system. China is a civil law country. However, under the code law format adopted by other civil law countries, contract law is a part of the civil code and does not exist parallel to and independently from the civil code. This differs from the practice in Anglo-American, or common law, countries, where there usually is an independent contract law, which is then either case law-based or codified. The situation in China is somewhat unique. The civil code, which is called the General Principles of Civil Law, does not have a separate chapter governing contracts, but instead splits contract law into three parts. Laws concerning the formation and effects of contracts are found in Chapter IV, Civil Legal Acts and Representation, which governs the expression and effects of civil behavior. The laws governing the rights, obligations, and performance of contracts are found in the debtor and creditor section of Chapter V, Civil Rights and Interests. Remedies for breach of contract are covered in Chapter VI, Civil Obligations. Thus, in the General Principles of Civil Law, there is no unified contract law, but separate rules under Civil Legal Acts, Creditor's Rights, and Obligations of Breach. While this format has some advantages from a jurisprudential point of view, it is extremely inconvenient in its actual operation. The Uniform Contract Law, which would break out of the confines of the General Principles of Civil Law and unify the separate parts, would be based on pragmatic considerations. However, the Uniform Contract Law cannot conflict with the General Principles of Civil Law. Accordingly, the coexistence of the General Principles of Civil Law and the Uniform Contract Law represents a unique combination of the strengths of the civil law and common law systems in China.

B. *General and Specific Provisions*

During the process of drafting the Uniform Contract Law, a dispute arose concerning the generality and specificity of the provisions. The codes of Roman law countries have both general and specific contract provisions. The general provisions cover rules applying to all types of contracts, and specific provisions cover specific types of contracts. This is not the case in Anglo-American law countries, where contract law generally covers all types of contracts. (At most, it separates out sales contracts from other specific contracts.) Since in China the resolution of a contract dispute is not case-law based, contract adjudication will suffer from great

inconvenience and a lack of uniformity if the rules covering specific types of contract are not set out in the contract law. Currently, ten types of economic contracts are specified in the Economic Contract Law and the basic rights and obligations of each type of contract are expressly stated. Hence, the debate resulted in a separation of general and specific provisions in the Uniform Contract Law according to the tradition of the Roman law system, due to practicability and ease of operation.

C. Types of Contracts

Another source of debate during the drafting process was the selection, among numerous types and categories of contracts in real life, of contracts to specify. In the Roman law system, there are so-called "enumerated contracts," or "typical contracts," as opposed to "unenumerated contracts," or "atypical contracts." But the "typical contracts" have not always been the same for different countries at different times. Since the general situation and system of ownership in China is considerably different from that in western countries, our own "typical contracts" to be specified in the specific provisions of the contract law should be decided according to the nature of our legal system and the extent of the use of such contracts in our socioeconomic reality. Under the current draft of the Uniform Contract Law, 21 types of typical contracts will be covered: (1) sales contracts; (2) contracts for the supply of electricity, water, heat, and gas; (3) responsibility contracts or subcontracts; (4) responsibility contracts for construction; (5) responsibility contracts for agricultural land; (6) transportation contracts; (7) leasing contracts; (8) financing and leasing contracts; (9) technology contracts; (10) loan contracts; (11) lending contracts; (12) gift transfer contracts; (13) safekeeping contracts; (14) storage contracts; (15) savings contracts; (16) accounting contracts; (17) contracts for commission; (18) factor contracts; (19) broker contracts for occupying space; (20) partnership contracts; and (21) employment contracts. There are other important contracts, such as insurance contracts, but because they are already covered in detail in laws such as the Insurance Law they are not provided for in the Uniform Contract Law. Other types of contracts, such as publishing contracts, performing contracts, travel contracts, health care contracts, and hotel contracts, are omitted because they are too numerous to list. However, since the current draft is still subject to revision, the listing of contracts will be subject to change at completion. Because the rights and obligations of so many different types of contract are voluminous, in order to achieve

convenience and clarity, only major rights, obligations, and characteristics will be covered. Even so, the new contract law will still have roughly 400 clauses, probably the largest number among China's current laws.

D. Socialist Market Economy

Contract law represents the economic relationships within a country. The nature of China's economic relationships reflects the fact that China is presently at a transition period. It is moving from a planned economy toward a market economy. The number and proportion of products produced under the planning system have decreased considerably, but they still make up an important part of the economy. A market economy remains a goal to be achieved. Therefore, the Uniform Contract Law cannot cover merely the contractual relationships under the market mechanism; it has to cover those relationships under the central planning mechanism in place. This is a very difficult problem for legislation because the standards for contracts under planning and market mechanisms are very different, and it is unrealistic to have two contract laws, one for contractual relationships under a market economy and one for those under central planning. The general provision of the Uniform Contract Law provides that "if contracts are required by state planning, parties shall do so in accordance with state instructions." The difference in specific rights and obligations, such as that between planned and unplanned transportation projects, will be set out within the specific types of contracts. This is also due to China's actual situation.

* * * * *

In summary, China's new Uniform Contract Law would have to wrestle with China's rapidly developing socialist market economy as well as allow China's contract laws to correspond more closely with international norms. In addition, a uniform contract law will be required in order to obtain the unification of China's current contract laws. As stated earlier, the UCL is not an attempt to reorder or reorganize China's existing contract legislation but a systematic redesigning of the form and context of the whole corpus of Chinese contract laws. This redesigning will be based on the following principles: the principle of uniformity, the principle of freedom of contract, the principle of protecting the interests of the creditor, and the principle of functionalism. The principle of uniformity comprises the goals of achieving the unity of domestic and foreign laws, the unity of

national and local laws, the unity of civil and economic laws, and the unity of subject-based and object-based laws. In order to further the principle of freedom of contract, the UCL will hopefully expand the discretionary rule in adjudicating contract disputes. Freedom of contract will also be supported by the UCL through the requirement of offer and acceptance, the expansion of the realm of voidable contracts vis-a-vis the realm of invalid contracts, and the expansion of the realm of contractual remedies. In order to further protect creditor interests, the UCL will allow the creditor to suspend his contractual obligations under special circumstances, to expand the rights of succession and renunciation, to broaden the right to unilaterally rescind a contract, to abolish the double standard concerning compensatory damages, and to strengthen the rights of a party who acts in good faith.

The UCL will therefore be quite a comprehensive and unifying document. There is still much discussion concerning how the UCL will incorporate both civil law and common law approaches to contract law and what degree of specificity the law should encompass. While the scale of this project is enormous, the drafting process has already begun. Hopefully, the UCL final draft will finally pass in March 1997, which will allow the UCL to begin to address the problems listed above in a unified and comprehensive manner.