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A Comparative Study of the Uniform Commercial Code and the Foreign Economic Contract Law of the People's Republic of China

by
Zhao, Yan†

INTRODUCTION

National economic reform and an "open door" policy in the past decade have led the Peoples' Republic of China [hereinafter PRC] to widespread involvement in international trade. Drastic changes and developments in the PRC economy have attracted many foreign investors and business people to this "untapped" market of over one billion people. Numerous contracts are executed each year between PRC and foreign companies in a variety of areas including technology transfers, sales of goods, and joint ventures. The increase in business transactions between countries that have not frequently traded with one another makes clarity in international commercial relations significant.

As U.S.-PRC trade has increased, the United States has emerged as one of the PRC's major trade partners. This growing trade has stimulated attorneys and business people to learn about the PRC's laws. This article seeks to promote greater clarity and understanding in U.S.-PRC business relationships by comparing the Foreign Economic Contract Law of the People's Republic of China [hereinafter FECL]¹ with the corresponding provisions of the Uniform Commercial Code [hereinafter UCC].

The FECL, effective July 1, 1985,² is the first statute in the PRC that applies solely to contracts involving a foreign party. The FECL's purpose is to protect the legitimate rights and interests of contracting parties and to

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1. The Foreign Economic Contract Law of 1985 (PRC) [hereinafter F.E.C.L.] was adopted at the Tenth Session of the Standing Committee of the Sixth National People's Congress on March 21, 1985. A full text of the official English translation was reprinted in 3 INT'L TAX & BUS. LAW. 1, 46-9 (1985). See Appendix for a copy of the translation.

2. F.E.C.L. art. 43.

promote the growth of trade.³ It consists of seven chapters,⁴ each containing a variety of articles.

Chapter 1 sets out general provisions and specifies the fundamental contract principles that underlie the FECL. Article 3 of Chapter 1 sets forth the principles of equality, mutual benefit, and mutual assent; these principles resemble the American common law doctrines of mutual assent and bargained-for exchange.⁵ The FECL encourages mutual agreement through negotiation and compromise.

Other underlying principles are the protection of the PRC's social order and public interests, and the prohibition of fraud and coercion in contract formation.⁶ For example, article 4 requires contracting parties to observe PRC laws and moral standards as well as trade usages and international treaties.⁷ Any contract inconsistent with PRC law or harmful to the public interest is void. Nevertheless, the contract will be enforced if the parties remove or correct those provisions of the contract that contradict the laws of the PRC or that harm the social and public welfare.⁸

The FECL gives contracting parties discretion to choose the law applicable to their contracts.⁹ In the absence of choice-of-law provisions in the contract, the law of the "most closely related country" shall govern.¹⁰ However, the privilege of choosing the applicable law is not available in contracts for joint ventures, cooperative management, or cooperative prospecting and development of natural resources.¹¹ These contracts must be governed by PRC law. Although the FECL is not retroactive *per se*, if a contract was entered into prior to the enactment of the FECL, the contracting parties may choose

3. *Id.* art. 1.

4. *See* Appendix.

5. F.E.C.L. art. 3.

6. *Id.* arts. 4, 9, 10.

7. *Id.* art. 4. *See also id.* arts. 5, 6, 9.

8. *Id.* art. 9. Article 11 requires a party responsible for the invalidity of the contract to pay damages to the other party for losses resulting from the invalidity. *Id.* art. 11.

9. Despite the plain language in the F.E.C.L., exercise of the choice-of-law discretion may be difficult as a practical matter. The majority of the foreign economic contracts are to be performed in the PRC. As a result, disputes over contract performance are most likely to occur in the PRC. As such, it may not be practical to choose a foreign law (non-PRC law) to resolve disputes in the PRC. Moreover, the general conflicts of law principle usually points to the law of the country where the contract is to be performed as the governing law of the contract. This principle may affect the parties' decisions, especially since the F.E.C.L. explicitly declares the applicability of trade customs and norms. Finally, choosing a foreign law may jeopardize the prospect of obtaining approval of the contract from the PRC government. For these reasons, PRC law appears to be the "choice" for the parties.

10. *Id.* art. 5.

11. *Id.* This limitation applies only to those types of contracts that are to be performed in the PRC.

it to govern the contract.¹² Where the applicable PRC law is silent, "international norms" shall govern.¹³ Priority is given to international treaties, however, where conflicts arise between PRC law and treaties.¹⁴

The FECL is applicable to "economic contracts"¹⁵ between PRC enterprises or business institutions and their foreign counterparts or foreign individuals.¹⁶ On its face, the FECL does not apply to PRC individuals—a reflection of the character of the PRC's state-controlled economy. The PRC state owns and operates major industries and businesses, and all foreign trade is conducted by or through government corporations or agencies. Despite the dramatic increase of private sector participation in the PRC domestic economy, the private sector has not yet become directly involved in international trade. It is conceivable, however, that as the private sector continues to grow, PRC individuals may be able to enter into foreign economic contracts and participate in foreign trade. The FECL would then have to be amended to cover private PRC parties.

Chapter 2 of the FECL provides the basic principles governing contract formation. Chapter 3 deals with fulfillment of contracts and contract breach. Chapter 4 sets out the law with regard to assignments of contracts while Chapter 5 specifies the premises and procedures to modify, cancel, or terminate contracts. Finally, Chapters 6 and 7 cover the settlement of disputes and provide a series of supplementary articles for the FECL.

Although this article is a comparison of the FECL and the UCC, it refers, at times, to other PRC laws and general contract practice in the PRC. The FECL is relatively incomplete, as it assumes the use of general contract principles without defining them.¹⁷

To understand PRC contract law, some knowledge of the PRC legal system is essential. The PRC is a civil law country where statutory law dominates and case law is non-existent. Courts apply statutes in the adjudication of cases, but do not create law. The legislative power vests in the National

12. Article 41 indicates the lack of retroactivity of the F.E.C.L. in the absence of an agreement by the parties to the contrary. *Id.* art. 41.

13. *Id.* art. 5. The "international norms" include commercial usages applicable to both private and government contracts as well as other international law principles and treaties.

14. *Id.* art. 6. The applicable treaties are those to which the PRC is a signatory or a party, excluding provisions to which the PRC has declared reservations.

15. "Economic contract" is defined as "an agreement between legal persons for achieving a certain economic purpose and for defining each other's rights and obligations." Economic Contract Law, art. 2 (PRC). This law applies to economic contracts entered into between PRC parties. It was adopted at the Fourth Session of the Fifth National People's Congress on December 13, 1981, and came into effect on July 1, 1982. *See* 2 CHINA L. REP. 61-82 (1983)(English translation of the law).

16. F.E.C.L. art. 2. Note that the F.E.C.L. explicitly excludes international transport contracts. *Id.*

17. For instance, the F.E.C.L. does not contain any explicit reference to some basic contract principles such as offer and acceptance. *See generally* F.E.C.L.

People's Congress and its Standing Committee.¹⁸ The function of statutory interpretation is exercised by the Standing Committee of the National People's Congress.¹⁹ Interpretations of the Standing Committee have legal effect and are binding on PRC courts. Despite this, the judicial branch has wide discretion in each individual case. Although a court's decisions are not law, they inevitably influence later adjudications by setting some precedent.²⁰

In the PRC, no separate legal systems exist for the national and the provincial governments.²¹ The laws promulgated by the National People's Congress apply to all provinces and other local governments throughout the country. However, the People's Congress and its Standing Committee of the provinces, the autonomous municipalities (Beijing, Tianjin, Shanghai), and the autonomous regions (Tibet, Xinjiang, Ningxia, Guangxi, and Inner Mongolia) can set up special rules to accommodate the differing characteristics of each locality, provided that these rules are consistent with the laws enacted by the National People's Congress or its Standing Committee.²²

It is also important to note that the PRC's state-controlled economy impacts greatly on both the FECL and general PRC contract law. The same is true of the impact that the private-sector economy of the United States has on the UCC. The discussion in this article will reflect how the differences in economic systems effect the two systems of contract law.

I. CONTRACT FORMATION

The rules of contract formation in the PRC and the United States have similar general principles, but their specific requirements are quite different. Since the FECL provisions on contract formation are incomplete, this part of the discussion relies mainly on PRC contract practice and other related laws. This section examines the three main elements of contract law essential to contractual relationships between PRC and U.S. parties: mutual assent (under both the FECL and the UCC), consideration (under the UCC), and government approval (under the FECL).

18. Chinese Constitutional Law arts. 58, 62(1),(3), 67(2),(3) (PRC). This law was adopted at the Fifth Session of the Fifth National People's Congress on December 4, 1982, and came into effect on that date.

19. *Id.* arts. 67(1),(4).

20. It is interesting to note that article 33 of the Organic Law of the People's Courts empowers the National Supreme Court to interpret statutes as to their application to adjudication of cases. The Organic Law of the People's Courts, art. 33 (PRC). This law was adopted at the Second Session of the Fifth National People's Congress on July 1, 1979.

21. The PRC provincial governments are roughly equivalent to the states in the United States.

22. Chinese Constitutional Law arts. 100, 116 (PRC).

A. Mutual Assent

One essential characteristic of a contract is that it is consensual—a voluntary relationship. Under both the UCC and the FECL, a contract is formed when parties manifest mutual assent to enter into a binding relationship. Section 2-204 of the UCC makes mutual assent an essential element of contract formation. It explicitly states that a contract “may be made in any manner sufficient to show agreement.”²³ Similarly, under article 7 of the FECL, a contract is established when parties “reach agreement” on the major terms.²⁴

American law uses an objective standard to determine mutual assent, taking into account the context of the contract and the surrounding circumstances of its formation. The existence of a contract is proven by the parties’ express or implied intent to contract, as shown either by words or by actions.²⁵ The UCC definitions of “contract” and “agreement” create this objective test of mutual assent. Section 1-201(3) defines an “agreement” as “the bargain of the parties in fact as found in their language or by implication from other circumstances.”²⁶ “Contract” is similarly defined as “the total legal obligation which results from the parties’ agreement.”²⁷

In contrast, the FECL contains no express provisions on how to determine mutual assent or agreement. However, by adopting international trade usages, the FECL implicitly accepts the reasonable commercial standard whereby mutual assent is objectively determined from the circumstances of contract formation.²⁸

The UCC treats mutual assent as an essential element of contract formation. A contract can be created with one or more terms left open as long as the parties intend to enter into an agreement and have a reasonably ascertainable ground to formulate a remedy. By this standard, the UCC does not require the parties to provide the exact measure or amount of damages, nor do the parties need to be in agreement on all contract terms.²⁹ Open terms can usually be filled by reference to the parties’ course of performance,³⁰ course of dealing,³¹ usages of trade,³² or the UCC “gap-fillers”.³³

23. Uniform Commercial Code [hereinafter U.C.C.] § 2-204 (1978).

24. F.E.C.L. art. 7.

25. See *supra* note 23.

26. U.C.C. § 1-201(3) (1978).

27. *Id.* § 1-201(11).

28. See *supra* note 13 and accompanying text.

29. U.C.C. § 2-204(3) (1978). “The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of ‘indefiniteness’ are intended to be applied. . . .” *Id.* comment.

30. U.C.C. § 2-208 (1978). See also *supra* notes 26-27 and accompanying text.

31. U.C.C. § 1-205 (1978).

32. *Id.*

Two interesting UCC “gap-fillers” are sections 2-305 and 2-309, which provide a “reasonableness” standard rather than a definite answer to the open terms.³⁴ Section 2-305 states that “a reasonable price at the time for delivery” should be charged if the contract lacks a price term.³⁵ Similarly, section 2-309 supplies “a reasonable time” for the time of delivery or other actions, if the contract fails to so provide.³⁶ The “reasonableness” standard creates considerable latitude for contracting parties and courts to complete the open terms of the contract.

In addition to filling gaps, the UCC automatically imposes implied warranties. The warranties of “merchantability” and “fitness for particular purpose” are available to a UCC buyer, unless otherwise excluded by the parties.³⁷ The UCC further provides specific standards for contracting out of these warranties. For instance, “merchantability” must be explicitly mentioned in order to disclaim the implied warranty of “merchantability”; a disclaimer of the implied warranty of “fitness for particular purpose” must be made conspicuously in writing.³⁸ These requirements offer increased protection to a buyer in dealing with a commercial seller.

In contrast to the UCC, the FECL requires not only that the parties reach an agreement or mutual assent, but also that certain terms be explicitly specified in the contract. These terms include the contract subject matter, price and terms of payment, remedies, and dispute resolution methods.³⁹ Parties may add other terms on which they mutually agree, as long as the proposed terms are consistent with PRC law and public interests.⁴⁰

It is interesting to note that the FECL specifically incorporates appendices as part of the contract.⁴¹ This incorporation may be particularly advantageous to a foreign party. Usually, the PRC party focuses on the major terms of the contract during the negotiations and gives little weight to the appendices. The foreign party may then try to compensate for any perceived shortcomings in the major terms by incorporating its terms in the appendices. Moreover, it may not be wise for the foreign party to insist on including marginally acceptable terms in the main body of the contract since this might jeopardize the chances for obtaining government approval of the contract. Hence, it may be a good strategy to put these terms in the appendix.

In both the PRC and the United States, mutual assent is often manifested through offer and acceptance. If one party makes an offer which a

33. The U.C.C. “gap-fillers” include section 2-305 (open price), section 2-308 (place for delivery), section 2-309 (time for performance), and section 2-310 (open time for payment or running credit). U.C.C. §§ 2-305, 2-308, 2-309, 2-310 (1978).

34. *Id.* §§ 2-305, 2-309.

35. *Id.* § 2-305.

36. *Id.* § 2-309.

37. *Id.* §§ 2-314, 2-315.

38. *Id.* § 2-316(2).

39. F.E.C.L. art. 12. *See also* F.E.C.L. arts. 13, 14, 15, 20, 23, 24, 29(4), 31(1), 35, 36, 37.

40. *See supra* note 8 and accompanying text.

41. F.E.C.L. art. 8.

second party accepts, the two have reached an agreement and created a binding contractual relationship. It is important, then, to examine how the UCC and the FECL treat the concept of offer and acceptance in the formation of contracts.

1. *Irrevocable Offer*

An irrevocable offer under the UCC is a firm offer made by a merchant in a signed writing that assures the offer will be held open for a period of time.⁴² Such an offer is irrevocable for the stated period, or, if no period is given, for a reasonable time not exceeding three months.⁴³

The concept of an irrevocable offer has broader scope in PRC law. Any offer made in writing is considered a firm offer and is therefore irrevocable.⁴⁴ A written offer usually contains definite terms and specifies the time period for which the offer remains open and during which it cannot be revoked. If no time is specified, the offer remains open for a reasonable period.⁴⁵

PRC law, unlike the UCC, does not limit extension of a firm offer to a "merchant," nor does it require that the offer be extended by a "merchant-offeror." In the PRC, the concept of "merchant" is virtually non-existent. Contracting parties, especially in the field of international trade, are usually government agencies or enterprises. The fact that an offeror may be a "merchant" as defined in a free market economy is irrelevant in determining whether the offer is irrevocable under PRC law. Hence, an American merchant receiving an offer from a PRC company can usually expect that the offer is irrevocable and will remain open for at least a reasonable period of time.

2. *Silence as Acceptance*

Under both U.S. and PRC contract law, silence does not usually constitute acceptance. However, each particular legal system recognizes certain exceptions to this general rule. Because silence may be ambiguous in many situations, it is likely to cause confusion in contract formation. It is important for both parties to understand how silence will be interpreted.

42. U.C.C. § 2-205 (1978). By making a firm offer irrevocable, the U.C.C. creates an exception to the common law doctrine which entitles an offeror to revoke an offer at will unless consideration is given.

43. *Id.*

44. An offer is irrevocable when it reaches an offeree. The irrevocability of an offer protects an offeree who reasonably relies on an offer to his or her own detriment. A revocation is only effective when it is received prior to or at the same time as the receipt of the offer by the offeree. UNIFORM LAW TEXT, CIVIL LAW 261-62 (Law Press 1983). PRC trade practice distinguishes a false offer from a true offer. A false offer is in fact an invitation to make an offer, whereas a true offer is a firm offer. A false offer usually contains such language as "subject to our confirmation," "subject to our prior sale," or "for your reference." A true offer, i.e., firm offer, usually contains major terms of the contract. UNIFORM LAW TEXT, INTERNATIONAL TRADE LAW 22 (Peking University Press 1983).

45. UNIFORM LAW TEXT, INTERNATIONAL TRADE LAW, *supra* note 44, at 23-24.

PRC contract law treats silence as acceptance only when accompanied by other statements or conduct which gives meaning to that silence.⁴⁶ If the parties mutually agree that silence will operate as acceptance, or that the parties have treated silence as acceptance in their past dealings, silence may constitute acceptance. U.S. contract law focuses on the existence of reliance. Silence can operate as acceptance if an offeror has been led to rely upon the silence of the offeree. Where the parties have had previous dealings and silence has been treated as acceptance in the past, the offeror's reliance will be considered reasonable unless the present dealings are distinguishable or the offeror had reason to believe that silence would not operate as acceptance in a particular situation.⁴⁷

PRC and U.S. law are similar in that they both look to any conduct that may give content to silence in a contractual setting. American and PRC parties should nevertheless be cautious. In international trade, differences in culture and business practice may give rise to conflicting understandings of silence in contractual arrangements. If the silence of one party creates genuine confusion, it is unlikely that a valid contract will be formed (unless the parties' course of performance or course of dealings indicates a mutual understanding that silence will operate as acceptance). In this situation, the parties will not have reached mutual assent or agreement about entering into a binding legal commitment.

3. *The Mirror-Image Rule*

The "mirror-image" rule requires that, for a contract to be created, the acceptance must conform to the exact terms of the offer; any deviation from the offer (no matter how minor) turns the purported acceptance into a counter-offer. The PRC adheres strictly to this rule in contract formation.⁴⁸ The UCC, however, rejects the "mirror-image" rule, stating that a "definite and seasonable expression of acceptance" is an effective acceptance, even if it contains terms different from or in addition to the offer.⁴⁹ To determine whether an acceptance is "definite and seasonable" and an "expression of acceptance," the UCC examines the response as a whole, not each individual term. When the "definite and seasonable" standard is satisfied, parties have reached mutual assent—a mutual understanding of the prospective deal—and thereby, have formed a binding contract.⁵⁰

46. Silence is not acceptance unless otherwise provided by law or by the parties. UNIFORM LAW TEXT, CIVIL LAW, *supra* note 44, at 263.

47. U.C.C. section 2-206(1) states that an offer usually invites acceptance "in any manner and by any medium reasonable in the circumstances," presumably including silence. *See also* RESTATEMENT (SECOND) OF CONTRACTS U.C.C. § 2-206(1) (1978) § 69 (1979).

48. UNIFORM LAW TEXT, CIVIL LAW, *supra* note 44, at 262.

49. U.C.C. § 2-207(1) (1978).

50. *Id.* §§ 2-207(2),(3). Between merchants, the U.C.C. further incorporates the proposed additional or different terms into the contract unless they are material alterations to the offer, the offer has expressly limited acceptance to the terms of the offer, or notification of objection to the terms is given in a timely manner.

Thus, an American merchant who replies with slightly different terms to an offer from a PRC company usually should not expect the PRC party to treat the response as an acceptance. To close the deal, the merchant must agree to the exact terms of the offer. Similarly, a PRC company should be aware that its response with different or additional terms (a counter-offer) may be treated as an acceptance by an American party. To avoid this, the PRC company may simply state clearly that the response is not an acceptance and that the contract will not be formed unless these additional terms are accepted by the American party.⁵¹

4. *The Mailbox Rule*

The moment of contract formation depends upon the rules for determining when an acceptance becomes effective. The issue of timing is particularly important in the formation of international business contracts, as such transactions involve time differences and large distances are the norm.

Two major rules govern the time of the effectiveness of acceptance: the receipt rule in civil law jurisdictions, and the dispatch or "mailbox" rule in common law countries. In the United States, an acceptance is effective from the moment it is dispatched, e.g., the moment it is dropped in the mailbox.⁵² In contrast, the PRC follows the receipt rule whereby an acceptance is not effective until it is in the physical possession of the offeror.⁵³ Thus, if PRC law governs a contract between a PRC and an American company, an acceptance from the American party is only effective when it finally reaches the PRC company. No contract will be formed if the acceptance is lost in the mail or otherwise destroyed in transit. On the other hand, if U.S. law governs, a contract will be formed although the acceptance is lost in transit and never reaches the PRC party.

B. *Consideration*

While under the common law, consideration is a prerequisite of contract formation, in a civil law jurisdiction, a contract can be created without any consideration.⁵⁴ In the PRC, a contract is enforceable even if it lacks consideration. American companies should be aware that a promise to a PRC company may be enforced under PRC law, despite the fact that the PRC company failed to provide any consideration.

51. In this way, the PRC company explicitly makes the acceptance "conditional on assent to the additional or different terms." *See supra* note 49.

52. The mailbox rule was established in the landmark case of *Adams v. Lindsell*, 1 B. & Ald. 681, 106 Eng. Rep. 250 (1818).

53. UNIFORM LAW TEXT, CIVIL LAW, *supra* note 44, at 262-63.

54. K. SUTTON, CONSIDERATION RECONSIDERED 1 (1974).

Although the general rule in the United States is that a promise is not binding on the promisor unless supported by the promisee's benefit or detriment,⁵⁵ the UCC has created an exception by allowing a firm offer to be binding without consideration.⁵⁶ On this point, the UCC and PRC law agree.

One issue related to consideration is the illusory promise. Both PRC and American contract law treat illusory promises as void. Each legal system, however, relies on a different rationale. Under the common law, a promise to do or not to do something at one's own discretion is insufficient consideration for a return promise, and thus is void.⁵⁷ An illusory promise is unenforceable in the PRC because it is indefinite: a contract containing such a promise is void for failure to meet the definiteness-of-term requirement.⁵⁸ The fact that an illusory promise lacks consideration is irrelevant to its invalidity under PRC law.

C. Government Approval

Although consideration is not an essential element of contract formation, PRC contract law requires government approval before certain contracts become binding. Article 7 of the FECL provides that a contract is not effective until it is approved by the government, if such approval is required by applicable PRC law.⁵⁹ For instance, a contract for a joint venture must be approved by the Ministry of Foreign Economic Relations and Trade of the PRC [hereinafter MOFERT] or local authorities designated by MOFERT.⁶⁰

55. RESTATEMENT (SECOND) OF CONTRACTS § 79 comment a, b (1979).

56. See *supra* note 42 and accompanying text.

57. RESTATEMENT (SECOND) OF CONTRACTS § 77 comment a (1979).

58. See *supra* note 39 and accompanying text.

59. F.E.C.L. art. 7.

60. "The establishment of a joint venture in the PRC is subject to examination and approval by the Ministry of Foreign Economic Relations and Trade of the People's Republic of China The Ministry of Foreign Economic Relations and Trade may entrust the people's government in the related provinces, autonomous regions, and municipalities directly under the State Council . . . with the power to examine and approve the establishment of joint ventures The entrusted office, after approving the establishment of a joint venture, shall report to the Ministry of Foreign Economic Relations and Trade for the record. A certificate of approval shall be issued by the Ministry of Foreign Economic Relations and Trade." Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, art. 8 [hereinafter Regulations]. This law was promulgated by the State Council on September 20, 1983, and came into effect on that date. Article 9 of the Regulations further provides the steps to obtain approval, including (1) submitting a project proposal and a preliminary feasibility study report to the department in charge of the PRC participant for examination and consent, and (2) applying for approval by MOFERT or its designated local authority, once consent is obtained from the department in charge. When applying for approval, the applicant must submit certain documents including the joint venture agreement and articles of association. MOFERT or its designated local authority shall decide whether to approve or disapprove the application within three months of receipt of the required documents. *Id.* arts. 9, 10.

Likewise, for a contract for technology transfer to be effective, approval from MOFERT or its designated local authorities is required.⁶¹

However, the approval process may cause trouble to foreign contractors, especially those who are unfamiliar with the PRC legal system, "because the PRC law requiring approval may not be published and because the PRC approval process and documentation are commonly not subject to scrutiny by foreigners."⁶²

The government approval requirement reflects the impact of the PRC's state-controlled economy on commercial transactions. The government's supervision and control of international contracts is necessary for the creation and enforcement of state plans. Government guidance is important, particularly since the PRC has recently opened its domestic market to foreign investors. By requiring approval, the government can, among other things, control or avoid a trade deficit and adjust the use of foreign currency to protect the domestic economy.

The recent dramatic growth in foreign trade in the PRC has created a strong need to simplify the approval process. The hurdle of obtaining approval from the PRC government has frustrated many foreign investors. The approval requirement has a chilling effect on the interested foreigners who are accustomed to a freer enterprise system. The need to promote trade and foreign investment has led the PRC government to relax the approval process and to provide other ways to accommodate the needs of the PRC and its foreign trading partners. For example, the government has promulgated rules which merge some government approval authorities,⁶³ allow for the

61. "The contract shall be submitted for approval . . . within thirty days from the date of execution, to the Ministry of Foreign Economic Relations and Trade of the People's Republic of China or other agency authorized by the Ministry. The approving authority shall approve or reject the contract within sixty days from the date of receipt. Contracts approved shall come into effect as of the date of approval. Contracts for which the approving authority does not make a decision within the specified period of time shall be regarded as approved and shall come into effect automatically." Regulations of the People's Republic of China on Administration of Technology Acquisition Contracts, art. 4. This regulation was promulgated by the State Council on May 24, 1985, and came into effect on that date.

62. Lubman, *The Foreign Contract Law: Another Legal Milestone*, CHINA TRADE REP., Vol. XXIII (May 1985).

63. The Standing Committee of the National People's Congress has proclaimed a Decision to merge a few government approval authorities into one. The Decision states that "[t]he Import and Export Commission, the Ministry of Foreign Trade, the Ministry of Foreign Economic Relations and the Foreign Investment Commission are to be merged into the Ministry of Foreign Economic Relations and Trade. Therefore, the approval power exercised by the Foreign Investment Commission stipulated in the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment and other pertinent economic legislation concerning foreign countries is correspondingly to be exercised by the Ministry of Foreign Economic Relations and Trade." The Decision of the Standing Committee of the National People's Congress on the Approval Power to be Exercised by the Ministry of Foreign Economic Relations and Trade Instead of the Foreign Investment Commission. This decision was adopted at the Twenty-sixth Session of the Fifth Standing Committee of the National People's Congress on March 5, 1983.

appeal of denials of import or export licenses,⁶⁴ and provide for the approval of foreign economic contracts within the special economic zones.⁶⁵

II.

REQUIREMENT OF A WRITING

The validity of a contract may sometimes turn on the existence of a writing.⁶⁶ The UCC and the FECL have different requirements in this area. The UCC Statute of Frauds generally requires that a contract involving \$500 or more be in writing.⁶⁷ The writing need only be signed by the party against whom enforcement is sought.⁶⁸ However, the FECL requirement is stricter than that of the UCC. For all foreign economic contracts, the FECL demands a writing signed by both parties.⁶⁹ Thus, to be effective under the FECL, a contract between a PRC and an American party must be in writing and signed by both parties.

The FECL further requires that, when a contract is formed through exchanges of written communication, a letter of confirmation signed and executed by both parties is required if requested by either party.⁷⁰ Failure to comply with this requirement makes the contract void. Although a letter of confirmation is a sufficient writing under the UCC, a failure to execute such a letter when one party so requires does not make a contract void.⁷¹

The FECL specifically demands that certain provisions of a contract be included in the writing: contract subject matter, quality, quantity, price, terms of payment, time and place of delivery, remedies, and dispute resolution.⁷² In contrast, the UCC requires only that the quantity term be in writing, and that the writing be sufficient to show that a contract for the sale of

64. One example is the Provisional Regulations of the Municipality of Shanghai for the Supply and Distribution of Goods and Materials and the Control of Prices for Chinese-Foreign Equity Joint Ventures. Under these Regulations, a joint venture may apply to the Shanghai Foreign Trade and Economic Commission when its application for import or export license is denied by the approving authority. The Commission will then refer the application to the appropriate authorities for purchases from domestic companies or sales to foreign companies. Provisional Regulations of the Municipality of Shanghai, arts. 3, 4. The Regulations came into effect on December 20, 1984. See 3 CHINA L. REP. 212-13 (1986) (English translation of the Regulations).

65. In the special economic zones, the local government has the authority to approve foreign economic contracts within its territory. For instance, article 5 of the Regulations on Foreign Economic Contracts of Shenzhen Special Economic Zone empowers the Shenzhen municipal government and its designated authorities to approve foreign economic contracts in Shenzhen. Regulations on Foreign Economic Contracts of Shenzhen Special Economic Zone, art. 5. The Regulations were passed by the Standing Committee of the Sixth People's Congress of Guangdong Province on January 11, 1984, and were promulgated by the People's Government of Guangdong Province on February 7, 1984, and came into effect on that date.

66. Cf. *infra* discussion in Part III of the writing requirement for contract modification.

67. U.C.C. § 2-201 (1978).

68. *Id.* § 2-201(1).

69. See *supra* note 59.

70. *Id.*

71. U.C.C. § 2-201(2) (1978).

72. See *supra* note 39 and accompanying text.

goods exists.⁷³ Hence, if the parties choose the FECL to govern their contract, they should, at least, include the statutorily required terms in the writing. On the other hand, if the parties choose the UCC as the applicable law, they need only to specify the quantity term in writing.

III. MODIFYING AN EXISTING CONTRACT

Contracts do not always remain fixed. When circumstances change, parties often seek to modify the terms of an existing contract. Under both the UCC and FECL, a contract can be modified if both parties agree to the change.⁷⁴

The UCC does not require consideration for contract modification, nor, in many cases, need the modification be in writing.⁷⁵ However, if a modification places a contract within the Statute of Frauds, the modification must be made in writing to be effective.⁷⁶ In addition, section 2-209(2) of the UCC authorizes parties to contract for greater formality; it allows them to require that any future modification be in writing.⁷⁷

The FECL resembles the UCC in that it does not require consideration to modify a contract.⁷⁸ However, a modification of any economic contract within the FECL is not effective unless it is made in writing.⁷⁹ The FECL also requires government approval for major modifications of contracts executed with the approval of designated state agencies. Without this approval, a modification is not effective.⁸⁰

In contrast to the FECL, PRC domestic economic contract law grants a greater degree of control to the government. In domestic contracts, non-consensual modifications are imposed when there are changes in the state plan

73. See *supra* note 68.

74. U.C.C. § 2-209 (1978); F.E.C.L. art. 28.

75. U.C.C. §§ 2-209(1),(2) (1978).

76. *Id.* § 2-209(3).

77. *Id.* § 2-209(2).

78. See *supra* note 54 and accompanying text.

79. F.E.C.L. art. 32.

80. *Id.* art. 33.

upon which the contract was made.⁸¹ In addition, when one of the contracting enterprises is eliminated, the contract can be modified by the remaining parties.⁸² Finally, a modification is void if it is harmful to the public interests or to state plans.⁸³

The FECL does not explicitly adopt these domestic standards. Yet, the impact of the PRC economy and state plans on foreign economic contracts cannot be completely disregarded. For instance, if the state promulgates a plan limiting the supply of certain raw materials which a PRC company has contracted to sell to an American company, the parties' commitment under the existing contract would inevitably be affected. In this situation, it is likely that the parties would have to renegotiate and modify their contract.

Even assuming that domestic economic contract rules do apply to foreign contracts, they will have little practical impact, since the government approval process, at least in the short run, substantially diminishes the possibility of inconsistencies arising between the proposed contract and the state plan. In the event an international contract (more likely one that is long-term) hampers a revised state plan, the PRC party would probably negotiate with the foreign party to reach some compromise satisfactory to the new state plan requirements.

IV.

EXCUSE FROM PERFORMANCE

A contract is binding upon both parties; each party has a legal obligation to carry out its terms. In certain circumstances, however, a party may be excused from the obligation to perform. In both the United States and the PRC, an unforeseen event that renders performance impracticable or substantially frustrates the purpose of the contract may discharge a party from its obligations to perform.⁸⁴

A. Basis for Excuse

Section 2-615 of the UCC describes an event that excuses performance as a "contingency, the non-occurrence of which is a basic assumption of the

81. "An economic contract may be changed or cancelled under one of the following conditions: 1) When both parties agree by mutual consultation, and when the change or cancellation does not harm State interests or affect State plans; 2) When the State plan on which the contract is based has been revised or cancelled; 3) When one party to the contract can no longer fulfill the contract because the plant or enterprise has closed down, stopped production or been converted to other uses; . . ." Economic Contract Law, art. 27 (PRC).

82. *Id.* These modifications reflect the new economic reform policies in the PRC under which inefficient enterprises or projects are closed down, and unqualified management groups are replaced. When any of these events occurs, contracts relating to these enterprises or projects may be modified or terminated accordingly.

83. See *supra* note 81. The same holds true for foreign economic contracts. See *supra* note 8 and accompanying text.

84. U.C.C. §§ 2-614, 2-615 (1978); F.E.C.L. art. 24.

contract.”⁸⁵ The FECL similarly defines the event as a “force majeure” which is unanticipated, unavoidable and unsurmountable by the contracting parties.⁸⁶ Both definitions include the element of unforeseeability. The UCC language does not include the word “unforeseen,” yet this requirement is implied in the nature of a “contingency.”

Although parties are free to define or limit the scope of events that will excuse performance of their contract, both the UCC and the FECL recognize a natural disaster as well as a civil or government action as a “contingency” or “force majeure.”⁸⁷ Since labor strikes are prohibited in the PRC, however, PRC law precludes a strike from being a “force majeure.”⁸⁸

To circumvent the widely-accepted trade usage that a labor strike is a “contingency” or “force majeure,” a MOFERT official has stated that labor strikes “can hardly be explained as unavoidable by either party concerned, thus it is inappropriate to list strikes as force majeure in general terms in a contract.”⁸⁹

In addition to labor strikes, government interference is also of particular concern to foreign parties. Due to the nature of the PRC’s state-controlled economy, government restrictions on commercial transactions are arguably foreseeable in most cases. To avoid confusion, MOFERT has made it clear that regulations which are in existence at the time of contract formation cannot be characterized as force majeure. On the other hand, regulations which are promulgated subsequent to contract formation can be considered as force majeure to discharge contractual obligations.⁹⁰

To determine commercial impracticability, the UCC requires that the “contingency” render the performance impracticable, not just burdensome or expensive.⁹¹ Under section 2-615, a mere increase in the cost of performance or a rise or collapse of the market does not usually excuse performance.⁹² Likewise, a party cannot claim impracticability if alternative ways of fulfilling its contractual obligations are available.⁹³

85. U.C.C. § 2-615(a) (1978).

86. F.E.C.L. art. 24.

87. *MOFERT Official's Answers to Questions on Foreign Economic Contract Law (IV)*, 28 CHINA ECON. NEWS 1-2 (July 29, 1985).

88. The 1978 PRC Constitution and the subsequent 1982 Constitution eliminated labor strikes from civil rights. Thus, labor strikes are prohibited in the PRC.

89. See *MOFERT*, *supra* note 87.

90. *Id.*

91. U.C.C. §§ 2-614 comment 1, 2-615 comments 4, 5 (1978). See also RESTATEMENT (SECOND) OF CONTRACTS § 261 comment d (1979). J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* 131-33 (2d ed. 1980). On its face, the U.C.C. “commercial impracticability” doctrine is available only to a seller. An argument can be made, however, that, in some instances, this doctrine should also be applied to a buyer. See U.C.C. § 2-615 comment 9 (1978). J. WHITE & R. SUMMERS, *supra*, at 128-29.

92. See J. WHITE & R. SUMMERS, *supra* note 91, at 131-33.

93. U.C.C. § 2-614(1) (1978).

In addition to the UCC "commercial impracticability," frustration of contract purpose also excuses a party from performance.⁹⁴ If the frustration is so substantial as to alter the very nature of the contract, performance becomes pointless.⁹⁵ However, if an unforeseen event has only deprived a party of certain advantages or made a transaction less profitable, that party will not be able to show the kind of substantial frustration necessary to excuse it from performance.⁹⁶

The FECL does not explicitly specify the standards for excuse of performance. It simply states that a party unable to perform its contractual obligations due to a "force majeure" is excused from any liability for breach.⁹⁷ In this broad statement, the FECL seems to include impossibility and impracticability, as well as frustration of the contract purpose as standards for excuse. However, in an elaboration on the stipulation concerning "force majeure," a MOFERT official has stated that the cases of force majeure should generally meet the following conditions:

- 1) It is something that occurs after the conclusion of the contract and its occurrence cannot be foreseen by the parties then; 2) It results neither from negligence nor fault of the parties concerned; 3) Its occurrence and subsequent consequences cannot be avoided or overcome by the parties concerned.⁹⁸

B. Effect of Excuse

Both the UCC and the FECL recognize that, to the extent a "contingency" or "force majeure" renders the performance of a whole contract impossible or impracticable, a party is excused from all of its contract obligations.⁹⁹ However, if only part of the performance is impeded, a party is excused only from that particular part of the contract that is impossible or impracticable to perform.¹⁰⁰ In both the United States and in the PRC, a party is obligated to perform those obligations unaffected by the "contingency" or "force majeure." Under the UCC, a seller must allocate available supplies among affected customers in a reasonable manner and must notify all customers of the allocation and of any delay in delivery.¹⁰¹ Likewise, a party

94. The doctrine of frustration of purpose was established in the landmark case of *Krell v. Heryn*, 2 K.B. 740 (1903). In contrast with "commercial impracticability," frustration of purpose is designed to protect a buyer or payor. This doctrine has not been explicitly adopted by the U.C.C. Nonetheless, it is applicable to U.C.C. transactions through incorporation of section 1-103.

95. RESTATEMENT (SECOND) OF CONTRACTS § 265 comment a (1979).

96. U.C.C. § 2-615 comments 4, 7 (1978).

97. F.E.C.L. arts. 24, 29.

98. See *MOFERT*, *supra* note 87.

99. U.C.C. § 2-615(a) (1978); F.E.C.L. art. 24.

100. U.C.C. § 2-615(b) (1978); F.E.C.L. art. 24.

101. U.C.C. § 2-615(b),(c) (1978). The buyer in that situation may accept the delayed or reduced supplies or terminate the contract. Termination is allowed in an installment contract, for instance, when the deficiency or delay "substantially impairs the value of the whole contract." *Id.* § 2-612(3).

operating under the FECL must continue to fulfill its unaffected obligations and seasonably notify the other party of the delay in performance.¹⁰²

V. DAMAGES

The UCC contains broader remedy provisions than the FECL. Remedies under the UCC include, in the case of a seller, cure, resale, and damages and, in the case of a buyer, cover, and damages.¹⁰³ In contrast, the FECL provides damages as the principal remedy for contract breach.¹⁰⁴

A. Damages Generally

The UCC allows an aggrieved party to recover for actual loss as well as consequential and incidental damages, in the case of a buyer, and incidental damages, in the case of a seller.¹⁰⁵ The formula for computing a seller's actual damages is the difference between the market price (at the time and place of tender of delivery) and the unpaid contract price plus any incidental damages, less any expenses saved by the breach.¹⁰⁶ The corresponding formula for the actual loss of an aggrieved buyer is the difference between the market price (at the time the buyer learns of the breach) and the contract price, together with any incidental or consequential damages, less the expenses saved by the breach.¹⁰⁷

Similarly, damages under the FECL are defined as any loss, including lost profits, caused by the breach.¹⁰⁸ The FECL uses the broad language of "further compensation" when remedial measures are insufficient, and does not differentiate among categories of compensatory (non-punitive) damages.¹⁰⁹ However, recoverable damages are limited to those damages foreseeable by the contracting parties at the time the contract was formed.¹¹⁰

Under the UCC, there is no requirement that the damages be foreseeable. The exception to this rule is that the buyer's consequential damages are limited to those of which the seller "had reason to know" at the time the

102. F.E.C.L. arts. 24, 25.

103. See generally U.C.C. §§ 2-702 to 2-721 (1978).

104. F.E.C.L. arts. 18, 19. In addition to damages, the F.E.C.L. provides cancellation as a remedy for material breach, i.e., when the breach "has seriously affected the economic interests anticipated." *Id.* art. 29(1). Cancellation is also available to an aggrieved party when the other party has failed to perform within the time specified in the contract and within an additional time after the breach when such time is given by the non-breaching party. *Id.* art. 29(2).

105. U.C.C. §§ 2-706 to 2-718 (1978).

106. *Id.* §§ 2-708, 2-710.

107. *Id.* §§ 2-713, 2-715.

108. See *supra* note 104. The F.E.C.L. allows a party to charge interest on any delayed payments. F.E.C.L. art. 23.

109. F.E.C.L. arts. 18, 19. The F.E.C.L. specifically requires that a party who causes the contract to be void to "compensate" the other party for damages. See *supra* note 8. With this provision, the F.E.C.L. strongly urges the parties to observe PRC law and other fundamental contract principles. Cf. *supra* notes 5-8 and accompanying text.

110. F.E.C.L. art. 19.

contract was formed.¹¹¹ In practice, actual loss is probably foreseeable in most cases. Thus, under both the FECL and the UCC, the foreseeability requirement has most of its impact on the determination of consequential damages.

B. Mitigation of Damages

The UCC has no specific provisions requiring an aggrieved party to mitigate damages. It does, however, provide certain remedies that have a mitigating effect, including "cover"¹¹² and "resale."¹¹³ Under the UCC, an aggrieved buyer purchasing substitutes and a seller reselling the contract goods must both act in "good faith" and with "commercial reasonableness."¹¹⁴ A failure to meet these standards deprives the buyer or seller of any cover or resale damages.¹¹⁵ Additionally, the UCC allows a defaulting seller to cure its default, thus avoiding potential losses.¹¹⁶ A seller who delivers non-conforming goods can cure the defects within the contract time or, in some instances, within an additional reasonable time. If the seller seasonably cures, the buyer is required to accept the now conforming goods from the seller.¹¹⁷

Unlike the UCC, the FECL explicitly requires an aggrieved party to promptly and properly mitigate against any loss arising from a breach of contract. Post-breach damages which could have been avoided had the non-breaching party taken proper steps to mitigate cannot be recovered.¹¹⁸

C. Liquidated Damages and Penalties

Both the FECL and the UCC allow parties to contract for liquidated damages in anticipation of future breach. The UCC, however, prohibits liquidated damages which exceed the reasonable amount of actual or anticipated losses. Under section 2-718(1), "[a] term fixing unreasonably large liquidated damages is void as a penalty."¹¹⁹ In contrast, the FECL allows any amount of liquidated damages, although a party may request a court or an arbitration

111. Consequential damages are also limited to those which could not "reasonably be prevented by cover or otherwise." U.C.C. § 2-715(2)(a) (1978).

112. "Cover" is defined in the U.C.C. as a buyer's "reasonable purchase of or contract to purchase goods in substitution for those due from the seller." *Id.* § 2-712(1).

113. The U.C.C. allows an aggrieved seller to resell the contract goods by private or public sale. *Id.* § 2-706(2).

114. *Id.* §§ 2-706(1), 2-712(1).

115. *Id.* A buyer or seller who has made a substitute purchase or resale in accordance with section 2-712 or section 2-706 is entitled to recover the difference between the contract price and the cover/resale price. However, where the cover or resale is not made in good faith or in a commercially reasonable manner, the buyer or seller cannot recover the cover/resale damages, but may recover damages under section 2-713 or section 2-708.

116. *Id.* §§ 2-508, 2-612(2).

117. *Id.* §§ 2-508, 2-612 comment 5, 2-612(2).

118. F.E.C.L. art. 22.

119. U.C.C. § 2-718(1) (1978).

agency to adjust liquidated damages which are too high or too low.¹²⁰ When a clause relating to liquidated damages is agreed to, a time limit for payment must be stipulated.¹²¹

The different views on liquidated damages in anticipation of breach reflect each country's policy concerns. In the PRC, every economic contract is made in accordance with state plans. One breach may cause a series of other breaches in related contracts, thereby jeopardizing the fulfillment of the plan objectives. A breach of contract is seen as harmful to the economy as a whole, and thus is penalized. On the other hand, in the free market economy of the United States, parties are free to contract for their own individual interests. A single breach will not affect the economy as much as it would in the PRC. Furthermore, in most instances, penalizing a breach is not wise if the parties are able to achieve their economic ends more efficiently through substitute transactions. For instance, an aggrieved buyer or seller may recover its loss by obtaining substitute performance in the free market.¹²² These alternative remedies are not usually available in the state-controlled economy of the PRC where there is virtually no "market" in which an aggrieved party may "cover" or "resell" at its own choice.¹²³

VI. DISPUTE RESOLUTION

The FECL contains a unique chapter which provides four means of dispute resolution: 1) consultation—friendly negotiations between the parties in dispute; 2) mediation—friendly negotiations with a third-party intermediary; 3) arbitration—contractual creation of a dispute resolution process; and 4) litigation—final determination by a government authority through an adversarial procedure.¹²⁴ In contrast, the UCC does not contain specific provisions on dispute resolution.¹²⁵

A. Friendly Negotiations

The FECL favors consultation and mediation by requiring that parties make every effort to settle disputes among themselves or with the help of a third-party.¹²⁶ Arbitration and litigation are recommended only when friendly negotiations fail.

120. F.E.C.L. art. 20.

121. See *MOFERT*, *supra* note 87.

122. See *supra* notes 112-15. Cover or resale enables an aggrieved buyer or seller to secure what he or she originally expected from the contract.

123. In case of breach, parties to an economic contract, usually state enterprises, can meet their economic needs only through adjustment by the state in the state market.

124. F.E.C.L. arts. 37, 38.

125. *But see infra* note 127 and accompanying text.

126. Article 37 of the F.E.C.L. states that the parties "shall do everything possible" to settle their disputes through consultation or mediation. F.E.C.L. art. 37.

The dispute resolution provisions in the FECL reflect the traditional PRC sense of community unity. In the PRC, friendly negotiations are the basic steps of resolving disputes. This method of dispute resolution is also strongly recommended in foreign trade. In contrast, the UCC's approach to dispute resolution is diametrically opposed to the FECL. The UCC does not mention consultation, mediation, or arbitration, apparently assuming litigation to be the primary means of resolving disputes.¹²⁷

The use of friendly negotiations in the PRC accelerates the process of resolution, saving both parties time and expense. Moreover, negotiations among the parties protect their reputation and credibility and reduce any latent hostility which might otherwise arise in arbitration or litigation. More importantly, friendly negotiations provide considerable convenience to parties in international trade who, oftentimes, are not familiar with the legal or arbitral system of the other party's home country. However, despite the advantages of friendly negotiations, neither consultation nor mediation is mandatory under the FECL. Parties may choose to arbitrate or litigate their disputes at the outset, or when consultation or mediation proves unsuccessful.¹²⁸

B. Suspension of Performance

Although the UCC does not mention consultation or mediation, it does suggest a way to avoid judicial proceedings. Section 2-609 permits a party to suspend performance and demand "adequate assurance of due performance" from the other party when "reasonable grounds" lead the insecure party to believe that the other's performance will be impaired and when the suspension is commercially reasonable.¹²⁹ This provision seems to promote non-legal methods of dispute resolution among the parties themselves.

The technique of "suspension of performance" is also available under the FECL. A party may suspend its performance when there is "concrete proof" that the other party could not fulfill its obligations.¹³⁰ The FECL further requires the party suspending performance to promptly notify the other party of its action.¹³¹ This gives the other party the chance to offer reasonable and adequate assurance of its future performance. These provisions diminish the potential for breach and, thus, subsequent litigation or arbitration.

The standard for "suspension of performance" is different under the UCC and the FECL. The UCC requires a showing of "reasonable grounds"

127. The implication of litigation is seen from the language of U.C.C. section 2-709 which reads that "where the seller *sues* for the price he must hold for the buyer any goods" (emphasis added) Another U.C.C. provision, section 2-716(3), also indicates the assumption of judicial proceeding by referring to the buyer's right of replevin.

128. See *supra* note 124.

129. U.C.C. § 2-609 (1978).

130. F.E.C.L. art. 17.

131. *Id.*

for insecurity to justify a demand or suspension of performance.¹³² The “reasonable grounds” may be implied from the parties’ course of performance or dealings in past transactions unrelated to the contract in question. Thus, a demand for suspension may be proper if one party’s actions impair the other party’s expectation of performance.¹³³

The test of “concrete proof” under the FECL is stricter than the UCC’s test for “reasonable grounds.” The FECL does not specify what constitutes “concrete proof.” Yet, the word “concrete” seems to require actual evidence, not just mere speculation, that the other party has breached the contract. The UCC’s standard of subjective belief or parties’ past dealings probably could not satisfy the “concrete proof” standard of the FECL.

C. Arbitration and Litigation

Arbitration and litigation are less favored as dispute resolution methods under the FECL than under the UCC.¹³⁴ In the PRC, foreign trade arbitration is usually handled by the Foreign Economic and Trade Arbitration Commission [hereinafter Commission] under the auspices of the China Council for the Promotion of International Trade [hereinafter CCPIT].¹³⁵ The Commission has jurisdiction over disputes involving international contracts, joint ventures, technology transfers, loans and financing, rentals, insurance, and other trade areas.¹³⁶

Fifteen to twenty-one members who have legal training and experience, as well as expertise in various business practices, sit on the Commission for a one year term.¹³⁷ The Commission applies its own procedural rules and the substantive law chosen by the parties. The arbitration award is binding; either party may request the People’s Court to enforce it.¹³⁸ The arbitration

132. See *supra* note 129.

133. “Under the commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the transaction in question.” For instance, “a buyer who requests precision parts which he intends to use immediately upon delivery may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs.” U.C.C. § 2-609 comment 3 (1978).

134. See *supra* notes 126-27 and accompanying text.

135. The Commission was first established in 1956 as the Foreign Trade Arbitration Commission to handle disputes involving the international sale of goods, shipments, and insurance. In February 1980, the Commission’s name was changed to Foreign Economic and Trade Arbitration Commission. Its scope of jurisdiction was broadened to cover disputes concerning joint ventures, technology transfers, international loans and rentals, and other trade disputes. Provisional Regulations on the Arbitration Commission, art. 2. The Regulations were adopted at the Fourth Session of the China Council for the Promotion for International Trade on March 31, 1956. Notice of the State Council regarding Changing “the Foreign Trade Arbitration Commission” into “the Foreign Economic and Trade Arbitration Commission” (Feb. 26, 1980).

136. *Id.*

137. The number of Commission members can increase if there is a need. Decision of the Central People’s Government Zheng Wu Yuan regarding Establishing the Foreign Trade Arbitration Commission under the China Council for the Promotion of International Trade, art. 3. The Decision was passed at the 215th Session of Zheng Wu Yuan on May 6, 1954.

138. Provisional Regulations on the Arbitration Procedure of the Foreign Trade Arbitration Commission, arts. 31, 32.

fee is set at a rate that does not exceed one percent of the total claim.¹³⁹ Chinese is the official language of the Commission proceedings; interpreters may be appointed for parties who do not speak Chinese.¹⁴⁰

CCPIT established a second commission, the Maritime Arbitration Commission, to handle disputes involving international shipping and admiralty.¹⁴¹ The Maritime Commission consists of twenty-one to thirty-one members, each serving a two year term.¹⁴² The Maritime Commission collects a fee that is not to exceed two percent of the total claim.¹⁴³ The procedural rules of the Maritime Commission are substantially the same as those of the Foreign Trade Arbitration Commission.¹⁴⁴

PRC arbitration incorporates mediation in its proceedings as the primary means to settle disputes.¹⁴⁵ Upon the parties' request, the Arbitration Commission, or the selected arbitration panel, will mediate between the disputing parties. If the parties reach an agreement, the Committee or panel will issue a "Mediation Award" and subsequently dismiss the case.¹⁴⁶

The FECL treats litigation as the last remedy available to parties involved in a dispute. In the absence of a written agreement to arbitrate, parties can resort to litigation if there is an objection to arbitration.¹⁴⁷ Cases involving a foreign party are adjudicated by the intermediate level of the People's Courts (*zhong ji ren min fa yuan*) or the courts of higher levels.¹⁴⁸

Although arbitration is available under U.S. law, some courts have not favored it, treating arbitration clauses as "material alterations" under section 2-207 of the UCC and excluding them from contracts.¹⁴⁹ Litigation is the major way of resolving disputes under the UCC.

139. *Id.* art. 33.

140. *Id.* art. 36.

141. Decision of the State Council regarding Establishing Maritime Arbitration Commission under the China Council for the Promotion of International Trade, art. 1. The Decision was passed at the 82nd Session of the State Council on November 21, 1958. Provisional Regulations on the Arbitration Procedure of the Maritime Arbitration Commission, art. 2.

142. Decision of the State Council regarding Establishing the Maritime Arbitration Commission under the China Council for the Promotion of International Trade, art. 3.

143. *Id.* art. 35.

144. *See generally* Provisional Regulations on the Arbitration Procedure of the Maritime Arbitration Commission.

145. For instance, article 2 of the Provisional Regulations for Maritime Arbitration explicitly states that the Maritime Arbitration Commission may mediate the claims. Provisional Regulations on the Arbitration Procedure for the Maritime Arbitration Commission, art. 2.

146. UNIFORM LAW TEXT, INTERNATIONAL TRADE LAW, *supra* note 44, at 438.

147. F.E.C.L. art. 38.

148. The PRC courts having jurisdiction over foreign trade disputes include (1) the National Supreme Court; (2) the Superior (*gao ji*) People's Courts of the provinces, autonomous regions and municipalities; (3) the Intermediate (*zhong ji*) People's Courts of the provinces, autonomous regions and municipalities; and (4) the Intermediate County (*Di qu zhong ji*) People's Courts. The Organic Law of the People's Courts, arts. 23, 25, 26, 28, 32. The Law of Civil Procedure (*shi xing*), arts. 17(1), 18, 19.

149. 2 R. ANDERSON, UNIFORM COMMERCIAL CODE 295-97 (3d ed. 1982).

The FECL provides for a four year statute of limitations for breach of a contract for the sale of goods.¹⁵⁰ The cause of action begins to run from the time a party learns or should have learned of the breach.¹⁵¹ Similarly, the UCC has a four year statute of limitations.¹⁵² Yet, the parties may shorten this statutory period to a minimum of one year.¹⁵³ For general contract claims, the statutory period begins to run when the breach occurs.¹⁵⁴ In case of a breach of warranties, the limitations period begins to run from the tender of delivery or from the time the breach is or should have been discovered if the warranty extends to future performance of the goods.¹⁵⁵

The methods of dispute resolution in the FECL and the UCC reflect the cultural and economic differences between the PRC and the United States. Friendly negotiations are the traditional means of resolving disputes in the PRC. This method mirrors the characteristics of the PRC's economy. The state-controlled economy promotes a strong sense of collectivity and community unity. When a dispute arises, citizens of the PRC prefer to negotiate and compromise rather than engage in adversarial legal battles.

In contrast, individualism is inherent in the free market economy of the United States. Free competition leads one to be aggressive in asserting and protecting one's own rights and interests. It is, therefore, natural and logical that litigation is commonly used and accepted in the United States. Nevertheless, in the area of international trade, parties should try to accommodate the differences in cultural, social, and economic backgrounds of their business partners. In this way, a more profitable and stable business relationship can be established.

CONCLUSION

The UCC and the FECL are domestic statutes governing, among other things, matters relating to contract formation, modification, and enforcement. Neither code is conclusive on all contract issues. The UCC brings the common law into play, while the FECL resorts to other PRC domestic statutes and general contract practice. Both the UCC and the FECL can be designated by the parties to international commercial transactions as the law governing their contract.

U.S. and PRC contract law share some similar canons of commercial contract practice. However, there are some significant differences between the common law and civil law of contract. The two nations' distinct viewpoints on economics influence their legal systems and create additional variations in the two statutes. The impact of the PRC's state-controlled economy

150. F.E.C.L. art. 39.

151. *Id.*

152. U.C.C. § 2-725(1) (1978).

153. *Id.*

154. *Id.* § 2-725(2).

155. *Id.*

is seen in FECL provisions, such as government approval and penalty damages. The UCC, on the other hand, reflects the free market ideology, emphasizing commercial reasonableness and economic efficiency.

It is important that attorneys and business people involved in U.S.-PRC trade be aware of the differences and similarities in contract law in planning their business transactions to minimize potential problems or disputes.